

U.S. COURT, U.S.  
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No. 91-798

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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1991

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SOUTH DAKOTA PUBLIC UTILITIES COMMISSION,  
MINNESOTA PUBLIC UTILITIES COMMISSION  
and PEOPLES NATURAL GAS COMPANY, a  
division of UtiliCorp United Inc.,  
*Petitioners,*

v.

FEDERAL ENERGY REGULATORY COMMISSION,  
*Respondent.*

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**BRIEF FOR RESPONDENT CONOCO INC.  
IN OPPOSITION TO PETITION FOR  
WRIT OF CERTIORARI**

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January 17, 1992

## **COUNTERSTATEMENT OF QUESTIONS PRESENTED**

1. Whether the Court of Appeals correctly held that substantial evidence was presented at an administrative evidentiary hearing in support of the conclusion that natural gas pipeline and producers intended the area rate clauses in their contracts to trigger the payment of Natural Gas Policy Act ceiling prices.

2. Whether substantial evidence was presented at an evidentiary hearing against Petitioners' contentions, given the fact that at such hearing they did not present the testimony of any witnesses, and their opponents presented the testimony of 70 witnesses.

**PARTIES TO THE PROCEEDING**

The parties to this proceeding are listed in the petition at pages ii and iii. Appendix A, *infra*, contains a list of the parent company and subsidiaries (except wholly owned subsidiaries) of respondent Conoco Inc. pursuant to Rule 29.1 of this Court.

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**On Petition for Writ of Certiorari  
To The United States Court of Appeals  
For the District of Columbia Circuit  
BRIEF FOR RESPONDENT CONOCO INC.  
IN OPPOSITION TO PETITION FOR  
WRIT OF CERTIORARI**

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This brief in opposition is submitted by Conoco, Inc., one of the oil and gas producer Respondents in the proceedings below before the United States Court of Appeals for the District of Columbia Circuit.

**OPINIONS BELOW**

The opinion of the Court of Appeals is officially Reported at 934 F.2d 346. The opinion of the Court of Appeals on Rehearing is reported at 941 F.2d 1233.

The opinions of the Federal Energy Regulatory Commission are Reported at 48 F.E.R.C. ¶ 61,177 and 50 F.E.R.C. ¶ 61,177 . Each of these decisions are contained in the Appendix to the petition. The initial decision of the presiding Administrative Law Judge issued May 11, 1988, appears at 43 F.E.R.C. ¶ 63,015; and is reproduced in the Appendix to this brief.

## **COUNTERSTATEMENT OF THE CASE**

### **A. Preliminary Statement**

Both the Natural Gas Act ("NGA") and the Natural Gas Policy Act of 1978 ("NGPA") contain identical language to the effect that "[t]he finding of the Commission as to the facts, if supported by substantial evidence, *shall be conclusive*." 15 U.S.C. § 717a(b) [NGA § 19(b)], *id.* § 3416(a)(4)] The decisions of both the Commission and the court of Appeals below represent an unexceptional application of the substantial evidence rule.

The Petition for a Writ of Certiorari (the "Petition") almost entirely omits any description of the testimony and documentary evidence which is contained in the administrative record and extensive hearings transcript of about 5,400 pages. Most importantly, Petitioners fail to apprise the Court that at the evidentiary hearing held before an administrative law judge they offered no witness testimony—not a single witness.

No witness testimony was offered or presented by Petitioner at such evidentiary hearing despite the fact their opponents presented the testimony of some 70 witnesses. Petitioners' opponents being Northern Natural Gas Company and numerous natural gas producers which

were parties to the 1200 natural gas supply contracts being contested by petitioners.

Petitioners have pointed to nothing in the record to show that either the Commission or the Court of Appeals under such circumstances erred in determining, that the evidence presented "overwhelmingly" supported their opponents' case. 934 F.2d. at 350; 48 F.E.R.C. at 61,651-52.

### **B. Statement of Facts**

In FERC Order No. 23-B, the Commission established a rebuttable presumption that "area rate clauses" in producer/pipeline contracts authorizing the payment of the maximum ceiling prices prescribed by the NGPA where the contracting parties asserts that this is their mutual intent. FERC Statutes and Regulations, Regulation Preambles 1977-1981 ¶ 30,065 and on Rehearing, *id.* at ¶ 30,073 (1979). In FERC Order No. 23-B, the Commission provided, however, that third parties (such as the petitioner utility commissions) could seek to rebut this presumption by filing protests. Both the Fifth Circuit and D. C. Circuit have affirmed the FERC Order No. 23-B presumption and related administrative procedure. See, *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied* 454 U.S. 1142 (1982); *Associated Gas Distribs. v. FERC*, 810 F.2d 226 (D.C. Cir. 1986).

### **Commission Proceedings Commenced**

Over eleven years ago, Petitioners commenced proceedings before the Commission under FERC Order No. 23-B, in an effort to challenge the contracting parties interpretation of certain area rule clauses in approximately 1200 natural gas contracts entered into prior to the enactment of the NGPA in 1978. Following pre-

liminary hearings on the question of whether a sufficient showing was made to justify further evidentiary hearings, a Commission administrative law judge concluded that Petitioners had failed to meet their evidentiary burden needed to overcome the regulatory presumption. He, therefore, dismissed Petitioners' protests. 28 F.E.R.C. ¶ 63,028 (1984). The Commission reversed this ruling of the Administrative Law Judge, and remanded the Petitioners' case for a full evidentiary hearing to determine the contracting parties' intent. 33 F.E.R.C. ¶ 61,355 at 61,455 (1985), *reh'g denied*, 34 F.E.R.C. ¶ 61,261 (1986).

### **Administrative Law Judge**

The Administrative Law Judge held extensive evidentiary hearings between November 12, 1986, and February 10, 1987, during which Petitioners' cross-examined 14 Northern witnesses and 56 producer witnesses, producing some 5,400 pages of transcript.<sup>1</sup> At that hearing Petitioner's "did not submit direct evidence or present testimony of any witness to support their claims." 43 F.E.R.C. ¶ 63,015 at 65,147; Appendix *infra* at 5a. Based on the record of these evidentiary hearings, the Administrative Law Judge issued a decision in which he found that Northern and its producers had "overwhelmingly" established that the area rate clauses contained in the contracts at issue were intended to trigger the payment and collection of NGPA ceiling prices. *Id.* at 65,149, 65,169; Appendix *infra* at 70a.

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1. These, together with the Commission, are Respondent parties in this proceeding before the Court.

## The Commission's Decision

Petitioners appealed the decision of the presiding Administrative Law Judge in favor of Northern and the Respondent producers to the full Commission. Upon its review the Commission affirmed the Administrative Law judge's reasoning and conclusions. . . ." 48 F.E.R.C. ¶ 61,177 at 61,653. In its decision the Commission further noted its affirmance of the Administrative Law Judge's decision was "mandated" by the Fifth Circuit's decision in *Hunt Oil Co. v. FERC*<sup>2</sup> *id.* at 61,651.

## Court of Appeals Decision

Petitioner's sought review of the Commission's decision by the Court of Appeals. The Court of Appeals, upon completing its review rendered a decision which determined without any hesitation, that there was "substantial evidence in support of the Commission's orders. . . ." 934 F.2d at 353. In affirming the Commission's decision, moreover, the Court of Appeals also noted that at the administrative evidentiary hearing Petitioners had "offered no witnesses", even though their opponents had presented the testimony of some 70 witnesses. 934 F.2d at 350.

Even this rebuke by the Court of Appeals, however, was not sufficient enough to defer Petitioners ongoing efforts to further bloat the record and delay the ultimate termination of these proceedings. Rehearing and rehearing en banc was sought by Petitioners solely on the theory that the Court of Appeals' opinion violates the principle of *SEC v. Chenery*, 332 U.S. 194, 196 (1947); namely that courts may judge the propriety of an administrative agency's actions "solely by the grounds in-

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2. 853 F.2d 1226 (5th Cir. 1988).

voked by the agency." 941 F.2d at 1234. According to the Court of Appeals, however, Petitioner's arguments in seeking a rehearing amounted to little more than an attempt to have the Commission "to embark on a wild goose chase." *Ibid.* The Court of Appeals, consequently, denied Petitioners' applications for both rehearing and rehearing en banc. 941 F.2d 1233.

## REASONS FOR DENYING THE WRIT

### I.

#### **THIS CASE PRESENTS A STRAIGHT FORWARD APPLICATION OF THE SUB- STANTIAL EVIDENCE RULE, RAISING NO ISSUE WORTHY OF REVIEW BY THIS COURT.**

Petitioners contend that both the Commission and Court of Appeals decisions "disregard the most basic principles of administrative law. . . ." Pet. at 7. They argue in this respect that the effect of these decisions is to deprive Petitioners "of basic due process rights to present evidence and argument addressing the standards by which their case would be judged." *Id.* at 8.

The determinations made below by the Commission and Court of Appeals—as well as by the presiding Administrative Law Judge—are unquestionably correct. The contention by Petitioners that they somehow have been deprived of their due process rights to present evidence is completely unfounded. To the contrary, the record herein clearly establishes that Petitioners in the administrative proceedings below were afforded extensive and full discovery from both participants and non-participants. This is illustrated by the fact that during the more than 7 years Petitioners had to prepare their case

prior to the administrative evidentiary hearing, Petitioners completed some 16 depositions. These depositions were completed by Petitioners prior to the administrative evidentiary hearing in several diverse cities; including Omaha, Nebraska; Houston, Texas; Washington, D.C.; and Denver, Colorado.

At the administrative evidentiary hearing, nevertheless, Petitioners did not even attempt to present an affirmative direct case. 43 F.E.R.C. at 63,147; Appendix *infra* at p. 5a. That is to say, Petitioners at the evidentiary hearing "did not submit direct evidence or present testimony of any witness to support their claims." *Ibid.* Instead, Petitioners sought to conduct their case solely through the cross-examination of the witnesses who testified for their opponents' case. Petitioners' lengthy cross-examination of their opponents' witnesses lasted for some 34 days.<sup>3</sup> Such lengthy cross-examination, however was ultimately found by the Administrative Law Judge to be totally ineffective to impeach the testimony as given by their opponents' witnesses. *Id.* at 65,153; Appendix *infra* at 22a. As a consequence, the Administrative Law Judge understandably found that the testimony given by the witnesses for the producer respondents "not only preponderated, but did so conclusively." *Id.* at 65,154, Appendix *infra* at 26a.

Applicable precedent establishes that under the circumstances the factual findings as made by the Administrative Law Judge are to be given special weight, and are not to be easily ignored by the Commission.

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3. Protestors entire reliance upon cross-examination in lieu of an affirmative case, merely validates the observation of Professor Wigmore: "No Case! Abuse the oppoent's witness." J. Wigmore, Evidence § 8c, 640 (Chadborne Rev. 1976 & 1981).

*Hunt Oil Co. v. FERC*, *supra* at 1235 and cases cited therein.

Furthermore, the preponderance in the number of witnesses in favor of Respondents, is not a circumstance which should be overlooked by the trier of fact. *Rodi v. Dean*, 138 F.2d 309, 310 (7th Cir. 1943)

In addition, this Court has long recognized that with respect to findings of fact as made by an administrative agency, they are deemed "final" if supported by substantial evidence. See, e.g., *Cincinnati N.O. & T.P. Ry. v. ICC*, 162 U.S. 184, 194 (1896); *Consolo v. Federal Maritime Commission*, 383 U.S. 607, 619-620 (1966); *Consolidated Edison Co. v. NLRB*, 305 U.S. 197 (1938). Substantial evidence is "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Consolo v. Federal Maritime Commission*, *supra*.

In short, the circumstances presented herein to the Court amount to nothing more than the Court of Appeals having applied the substantial evidence rule against testimony to support of their contentions regarding contract interpretation.

## II.

### **THE COURT OF APPEALS DECISION DOES NOT SET ASIDE OR MODIFY THE PRIOR PRECEDENTS OF THE FEDERAL COURTS OF APPEALS REGARDING FERC ORDER NO. 23.**

Petitioners contend at some length (Pet. 8-13) that the decision below conflicts with earlier rulings regarding the FERC Order No. 23 of both the Fifth Circuit and District of Columbia Circuit regarding the FERC

Order No. 23. They fail, however, to point to any specific evidence whereby the trier of fact below erred in determining that the particular area rate clauses in question were intended by the contracting parties to trigger the payment of highest applicable ceiling prices as established by Federal regulations, including those prescribed by the NGPA. In an attempt to create a conflict with prior FERC Order No. 23 appellate decisions, Petitioners depend primarily upon the Court of Appeals' discussion of the contracting parties intent relative to the scope Petitioners where they did not find any witness to present of the area rate clauses at issue. Contrary to Petitioners assertions of a conflict, the Court of Appeals actually followed the controlling precedents of both the Fifth Circuit and D.C. Circuit. See, *Pennzoil v. FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); and *Associated Gas Distribs v. FERC*, 810 F.2d 266 (D.C. Cir. 1987). Indeed, in both these Appellate decisions as cited by Petitioners, it is recognized that the central question to be decided at the administrative evidentiary hearing was whether the contracting parties mutually intended in the area rate clauses at issue to authorize the collection of the NGPA ceiling prices. Petitioners ignore the actual holdings of these cases, as well as the Fifth Circuit's decision in *Pennzoil v. FERC*, 789 F.2d 1128. (5th Cir. 1986), and *Hunt Oil Co. v. FERC*, 853 F.2d 1226 (5th Cir. 1988). All these precedents clearly establish that the factual determination as the contracting parties' intent regarding area rate clauses must be based upon a weighing of " 'all evidence' - contract language, oral, and written extrinsic evidence and evidence of course of performance." *Hunt Oil Co.*, *supra* at 1237, and cases cited therein. Petitioners arguments

simply cannot be squared with the holdings in the prior decisions concerning FERC Order No. 23.

### CONCLUSION

For the reasons set forth above, the Petition for a Writ Certiorari should be denied.

Dated: January 17, 1992

Respectfully submitted,

By: \_\_\_\_\_

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**APPENDIX A**

Pursuant to Rule 29.1, the following is a list of parent and subsidiary companies (except wholly owned subsidiaries).

CONOCO INC.

E. I. Du Pont De Nemours, Inc. (parent)

Big Sky of Montana Realty, Inc.

Cit-Con Oil Corporation

Conch International Methane Ltd.

Conoco Amazons Limited

Conoco Arabia Limited

Conoco Buton Ltd.

Conoco Cabinda (Angola) Ltd.

Conoco Cegonha (Angola) Ltd.

Conoco Dabaa Ltd.

Conoco El Hamma (Tunisia) Ltd.

Conoco Faghur Ltd.

Conoco Iraq Ltd.

Conoco Kayes (Congo) Ltd.

Conoco Kouilou (Congo) Ltd.

Conoco N-dombo (Gabon) Ltd.

Conoco North Ras Qattara Ltd.

Conoco North Sitra Ltd.

Conoco Onango (Gabon) Ltd.

Conoco Peru

Conoco South Umbarka Ltd.

Conoco Spain Ltd.

Conoco Warim Ltd.

Conoco West Ras Qattara Ltd.

Conoco Yemem (Aden) Ltd.

Conoco Yemen (Sanaa) Ltd.

Dubai Exploration Onshore Company

Felix Oil Company

Jupiter Chemicals, Inc.

Kettleman North Dome Association

Oberrheinische Mineraloelwerke

Petrocokes, Ltd.

Petroleum Terminals, Inc.

The Seagram Company Ltd., through its wholly owned subsidiary companies owns approximately 24.5 percent of the common stock of Conoco's parent, E. I. Du Pont De Nemours, Inc., and Company  
The Standard Shale Products Company  
Tidelands Royalty Trust

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## APPENDIX B

NORTHERN NATURAL GAS COMPANY,  
Division of Eron Corporation,  
Docket No. GP80-43-009 (Phase I) Remand  
INITIAL DECISION

(Issued May 11, 1988)

Stephen L. Grossman,  
Presiding Administrative Law Judge.

\* \* \*

### I. *Background*

This is a third-party protest proceeding conducted pursuant to the Order No. 23 series rulemakings. The protest involves the proper interpretation of area rate clauses (ARCs) in more than 1200 natural gas purchase contracts executed prior to passage of the Natural Gas Policy Act of 1978 (NGPA) between Northern Natural Gas Company, Division of Enron Corp. (Northern or the Company) and various producers (Producers) (collectively Parties). This case was initiated in November 1979 when the Minnesota and South Dakota Public Utility Commissions (PUCs) and the Federal Energy Regulatory Commission (Staff) (collectively Protestors) objected to the Parties' claim that ARCs authorized Northern to pay ceiling prices established by the NGPA

for certain categories of gas subject to the Commission's jurisdiction. In 1986, Peoples Natural Gas Company (Peoples) also joined as a protester in this proceeding. Both Peoples and Northern were previously subsidiary companies of InterNorth, Inc., prior to its incorporation into Enron. Peoples, now a Northern customer, is an intrastate local distribution company (LDC) owned by UtiliCorp United, Inc.

The precise issue set for review is whether the Parties *intended* ARCs to trigger payment of NGPA ceiling prices when the contracts at issue were entered into. *Northern Natural Gas Company*, 33 FERC ¶ 61,355, at p. 61,706 (1985). The Parties agree that they had such an intent. Protesters, however, argue numerous theories in opposition.

Under Order No. 23 third-party protest procedures, where the contracting parties agree that an ARC was intended to authorize collection of ceiling prices under the NGPA, there is a presumption in favor of their interpretation. Third-parties have the burden to produce reliable and probative extrinsic evidence which specifically contradicts the parties' intent in order to rebut and thereby "burst the bubble" of this presumption. *Associated Gas Distributors v. FERC*, 810 F.2d 226, 228 (D.C. Cir. 1987). Once the presumption disappears, the contracting parties have the burden to prove their mutual intent by a preponderance of the evidence. *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982) (*Pennzoil I*). The parties may still, however, introduce evidence of their mutual assertion of intent and contract language in order to establish the proper ARC meaning. See *United Gas Pipe Line Co.* 40 FERC ¶ 61,062, at p. 61,174 (1987).

Initially, Protestors supported their position by arguing that the ARC language refuted the Parties' claimed intent. On March 12, 1981, however, Staff supplemented its protest with the introduction of a pleading filed by Peoples, then a division of InterNorth, in a declaratory judgment action in Federal District Court involving an intrastate contract with McCoy Petroleum Company (McCoy). In its pleading Peoples denied that its ARCs triggered payment if NGPA prices except to the extent that such prices were cost-based. 33 FERC ¶ 61,355, at p. 61,705. Since both Northern and Peoples had the same parent company, Staff asserted that Peoples' pleading constituted reliable and probative evidence that Northern did not intend to pay NGPA ceiling prices pursuant to ARCs.

On August 31, 1983, a hearing was set to establish whether Peoples' views reflected those of Northern. 24 FERC ¶ 63,085 (1982). On August 10, 1984, an Initial Decision was issued dismissing the case because it was found that the Peoples evidence was not reliable and probative evidence of Northern's intent, for Order No. 23 purposes. 28 FERC ¶ 63,028, at p. 65,093. On December 12, 1985, however, the Commission reversed this finding and remanded the proceeding for a hearing to determine the Parties' intent. 33 FERC ¶ 61,355.

Prehearing conferences were held following the Commission's order, to establish procedures and define which contracts were at issue. See 34 FERC ¶ 63,117. Despite having had prior extensive discovery during this proceeding, Protestors were granted further opportunities to gather information from all Producers and Northern Protestors conducted depositions of fifteen Northern witnesses

and deposed the Producers' except witnesses Mr. Jack Earnest. Additionally, Protestors submitted data requests on the Parties and received voluminous documents as a result. After having seven years to prepare its case, and two opportunities to examine all of Northern's files, Protestors nevertheless did not submit direct evidence or present testimony of any witness to support their claims.

On November 12, 1986, the hearing commenced. Protestors were limited to cross-examination of the Parties' witnesses for impeachment purposes, since they failed to present an affirmative case. (Tr. 562, 3058, 3148-49) Wide latitude of questioning was permitted, however, during cross-examination. (*See e.g.*, Tr. 803, 826, 5056.) Protestors cross-examined fourteen Northern Witnesses and fifty-six Producer witnesses. After observing and listening to the witnesses at hearing, and upon reviewing the proffered but not introduced testimony of the remaining Producer witnesses, the Presiding Judge determined no new information would be elicited from the fifty-eight Producer witnesses who had yet to testify. The record was closed on February 10, 1987, because the only testimony yet to be presented would have been cumulative. (Tr. 5862-5863, 5958) The previously submitted testimony of the non-testifying parties were disregarded, but those producers were permitted to submit briefs on the basis of the record testimony. (Tr. 5814-5816)

Subsequent to the record closing, Protestors were allowed a final opportunity to gather evidence through post-record closing discovery for a forty-five day period beginning February 10, 1987. (Tr. 5949) Still, not process of law and to raise her innocent spouse defense was found.

Initial Briefs were filed on August 3, 1987. Reply Briefs were filed on October 20, 1987. Rebuttal Briefs were submitted December 18, 1987.

## II. *Legal Standards*

As discussed *supra*, we are now at the stage of this proceeding where the burden of proof is on the contracting parties to prove, by a preponderance of the evidence, that their mutual intent at the time of contract execution was that the ARCs in issue would allow for payment of NGPA ceiling prices. To satisfy the preponderance of the evidence standard, the evidence must be of a greater weight and more convincing than that which is put forth by the opposition. *Smith v. United States*, 557 F.Supp. 42, 51 (W.D. Ark. 1982), *aff'd*, 726 F.2d 428 (8th Cir. 1984).

In conducting this inquiry, State contract law principles are to be applied. *Pennzoil I*, 645 F.2d at 387. Since the sale of natural gas is considered as a sale of goods under the Uniform Commercial Code (UCC), general UCC rules will be used in this case. *See Id.* *Pennzoil Co. v. FERC*, 789 F.2 1128 at 1142 (5th Cir. 1986) (*Pennzoil II*). (Louisiana is the only state relevant here which has not adopted the UCC, but its contract law is consistent with general UCC principles applied here.) Accordingly, relevant factors to consider are the contract language, course of performance, course of dealing, usage of trade, and the commercial and regulatory context in which the contracts were negotiated. Also, as explained previously, all other extrinsic evidence, such as the contracting parties' assertions of intent, must be reviewed. *Pennzoil II*, 789 F.2d at 1140-45.

Because Staff and PUCs have not presented a direct case, the Parties' evidence will preponderate if it is found that the proven evidence is credible. The trier of fact determines credibility by evaluating the witnesses' perception, memory and narration. Charles T. McCormick, *McCormick on Evidence*, Ch. 5, p. 72, n.1 (3rd Ed. 1984). Despite Protestors' arguments to the contrary, evidence elicited on cross-examination is not substantive evidence and cannot be used by a party to present its case-in-chief. *Refrigeradora Del Noroeste, SA v. Appelbaum*, 138 F. Supp. 354, 360 (N.D. Ill. E.D. 1956), *modified on other grounds*, 248 F.2d 858 (7th Cir. 1957), *cert. denied*, 356 U.S. 901 (1958). If Protestors desired to establish their case by testimony of particular witnesses, it should have called those witnesses in support of their affirmative case. *See United States v. Buchanan*, 500 F.2d 398, 399 (5th Cir. 1974) (*per curiam*).

Protestors try to inject into the proceeding certain legal theories which are unfounded and lack precedential authority. First, they allege that in order for a particular producer to prevail in this case it must appear individually and present evidence of its intent. (PUCs Br. at 67; Staff Br. at 16) This proposed rule of law is entirely without support. As the Fifth Circuit explained in *Pennzoil I*, 645 F.2d at 392, it is sufficient to prove the parties' intent by the contract language, commercial context and other probative extrinsic evidence, "without the testimony of those who negotiated the contract." Furthermore, in *Pennzoil II*, the Fifth Circuit approved the Administrative Law Judge's method below of conducting the Order No. 23 proceeding which included making findings for groups of producers based on the totality of the testimony of a representative sample. *See*

*Pennzoil II*, 789 F.2d at 1145 n.44. Therefore, testimony which is representative of all producers will sufficiently satisfy the required evidence needed for them to meet their burden of proof. Moreover, Northern as a party to each contract, can and did testify as to the mutual understandings underlying every negotiation.

PUCs also contend that each Producer must testify since each possesses certain "unique evidence", or else an adverse inference must be drawn against that producer. (PUCs Br. 82-83). In this case, however, there was no showing that any producers possess unique information which was unavailable to Protestors. Protestors had over seven years to develop their case. The time for asserting that they were deprived of such materials has long since passed. Northern and Producers have the right to formulate their own case presentation and introduce evidence from those witnesses who they feel will most effectively support their contentions. Additionally, PUCs' allegations that Northern actively withheld evidence of relevant facts, and that Northern presented unknowledgeable witnesses when potentially knowledgeable ones were available, are meritless and highly inappropriate. (PUCs Br. at 68)

Second, Protestors argue that evidence must be presented on a contract-by-contract basis, and therefore, any producer not introducing evidence which pertains to a particular contract cannot prevail in regard to that contract. (Staff Br. at 38; PUCs Br. at 46-69) This claim is premised on the Court's declaration in *Pennzoil I*, 645 F.2d at 386-387, that state law, instead of federal common law, should apply in Order No. 23 proceedings on a case-by-case basis to all jurisdictional natural gas purchase contracts. There was absolutely no mention

by the Court, however, of a need for a contract-by-contract adjudication in third-party protest proceedings. Case-by-case, in the context employed by the Court, simply means pipeline-by-pipeline adjudication. That is precisely what is done here. In fact, as explained *supra*, the applicable state law requires considering extrinsic evidence of course of performance, course of dealing and usage of trade to interpret the parties' intent. The very essence of considering such evidence is to determine whether there was a general understanding between the Parties, or in the industry as a whole, as to the meaning of such clauses. For example, the evidence could establish that based on the Parties' general understanding, a particular meaning attached to ARCs regardless of words used or specific circumstances related to each contract. There is no need to introduce contract-by-contract evidence to support such a finding.

Finally, Staff's reliance on Opinion No. 77 to ascertain the Parties' intent is misplaced. (Staff Br. at 38-41) In Opinion No. 77, *Independent Oil and Gas Association of West Virginia*, 10 FERC ¶ 61,214, at p. 61,398 (1980), the Commission explained that ARCs will generally not authorize collection of NGPA rates if the contract clause "contains the following disqualifying terms:"

- (1) It refers to rates established or prescribed by an administrative body;
- (2) It couples the reference to administrative action with reference to the Natural Gas Act or the "just and reasonable" standard of that Act, and
- (3) It contains no additional language which has the effect of uncoupling the link between agency action and the statutory standard of the Natural Gas Act. *Id.*

On brief, Staff argues that since these three prongs were satisfied, “[o]nly if Northern and producers can provide satisfactory extrinsic evidence of contemporaneous communications of intent can they prevail.” (Staff Br. at 41) Staff, however, cites no support for such a standard and no precedent has been suggested. As the court stated in Opinion No. 77, these three factors are only considered “[i]n those cases where there is no reliable and probative evidence of intent or where such evidence is inconclusive”. 10 FERC ¶ 61,214, at p. 61,398. As discussed *infra*, in this case there is reliable and probative evidence of the Parties’ mutual intent, and it is not only conclusive, but overwhelmingly so. Therefore, the Opinion No. 77 formula is not applicable here. Additionally, Opinion No. 77 was, by its terms, applicable to second-party protests (i.e. disputes between the pipeline and the producer), not third-party proceedings such as that here considered.

### III. *Contract Language*

The first step in determining the meaning of ARCs is to evaluate the contract language. *Pennzoil II*, 789 F.2d at 1140. “The words of the contract establish a universe of reasonable interpretations; evidence of the parties’ intent guides the [court] in choosing among these possible interpretations.” *Id.* at 1141.

When evaluating the words used in ARCs, the commercial and regulatory context and all extrinsic evidence of intent must be considered. The Commission has expressly rejected the “plain meaning rule,” which requires that unambiguous contracts be interpreted by looking only at contract words. *See Pennzoil I*, 645 F.2d at 369.

On brief, Staff categorizes the ARCs at issue into five general types and lists sub-types within each category. (Staff Br. at Appendix A). They contend that all ARCs either do not specifically permit collection of higher prices under the NGPA or if they do, the ARCs were not in effect for the periods at issue in this case. In the text of its brief, Staff claims that ARC language unambiguously allows only for administratively-set rates. (Staff Br. at 30, 41)

PUCs contend that particular types of ARCs at issue plainly preclude collection and payment of NGPA prices. (PUCs Br. at 247-254) They argue that clauses not referring to congressionally-set rates, but which recognize that other bodies could take actions triggering application of ARCs, do not allow payment of NGPA prices. PUCs also state that certain types of clauses have already been found by the Commission to be incompatible with the Parties' stated intent. PUCs, however, have introduced no testimony or documentary evidence to support their claims. They rely entirely on unsupported innuendo and speculation. There is nothing within the four corners of Northern's contracts to substantiate the PUCs' arguments.

The Parties allege that all ARCs allow for and require payment and collection of NGPA ceiling prices. Northern's witness, Mr. McCarthy, stated that the words used were intended to require Northern to pay and the Producers to collect the highest prices (regulated) allowed by law. (NNG-1 at 8) Mr. Earnest, the Producers' expert witness, stated that there was a general industry understanding that ARC language accurately expressed the Producers' intent to collect the regulated ceiling price. (IP-R-1 at 10-11)

As the Fifth Circuit stated in *Pennzoil I*, 645 F.2d at 388.

[a]mbiguity easily arises when the contract is applied to the subject matter in changed circumstances. Area rate clauses are certainly ambiguous as applied to the collection of currently available ceiling rates for natural gas. A contract should be interpreted in light of the changed circumstances to accomplish what the parties intended.

Although Protestors concentrate on the words used in ARCs to derive the meaning of the clause, as is discussed infra, the facts in this case show that the particular words were generally irrelevant to the Parties' intent. None of the clauses at issue restrict ARC meaning such that they can only allow for payment of administratively-set, cost-based rates. The Parties changed ARC wording over the years to keep pace with Commission regulations, but at all times the clause was intended to have an expansive intent obligating Northern to pay the generally-applicable ceiling rate. In order to determine proper ARC meaning, an analysis of the changed circumstances relating to ARCs is necessary.

As between the contracting parties in this case, ARC language is unambiguous. At all times they have agreed that NGPA ceiling prices are triggered by ARCs. As to third parties, however, the words used are ambiguous. This ambiguity is found because the ARCs do not expressly prohibit collection of NGPA rates, and not because the language is insufficient to allow for collection of NGPA ceiling prices. Consequently, consistent with the findings in *Pennzoil I*, an evaluation of the extrinsic evidence must be undertaken to determine whether the Parties' mutual intent at the time of contract execution was to allow for collection of NGPA ceiling prices.

#### IV. *The Parties' Testimony of Mutual Intent*

##### A. *Testimony of Northern's Intent*

Northern sponsored the testimony of fifteen witnesses to support its position that ARCs triggered payment of NGPA ceiling prices. Fourteen of these witnesses were cross-examined by Protestors during the hearing (the other witness, Mr. T. N. Wright, died subsequent to the filing of his testimony in the pre-remand phase of this case). These witnesses were directly involved in the drafting, negotiation, execution and administration of the ARCs at issue. Their testimony covers the entire time from Northern's first use of ARCs through the period when the Company began payments of NGPA ceiling rates. The testimony overwhelmingly shows that Northern's intent, at the time it entered into contracts with ARCs, was to pay any regulated ceiling price pursuant to these clauses. By the term "ceiling price", it is abundantly clear that the Parties contemplated such prices authorized by the appropriate government body and applicable generally and uniformly throughout the affected industry in essentially an automatic, self-operating manner.

Northern's first witness to testify at hearing was Mr. Patrick J. McCarthy, an attorney with the Company from 1955-1986. Mr. McCarthy and his staff were responsible for handling legal matters related to gas supply for Northern, its parent company and various operating divisions and subsidiaries. (NNG-R-1 at 3-5) This included drafting and negotiating contracts with ARCs, as well as advising personnel during the contract negotiation process. (NNG-R-1 at 7-8) Mr. McCarthy was familiar, therefore with ARC language and Northern's intent. (*Id.* at 14)

Mr. McCarthy consistently testified that Northern intended ARCs to trigger payment of NGPA ceiling prices.

(*Id.* at 8-9) This is consistent with statements he made in a memorandum prepared for Northern's management on November 6, 1978, immediately subsequent to Congressional enactment of the NGPA. (NNG-R-2) Also, this same intent was expressed in a letter responding to a producer inquiry in 1979. (NNG-R-3)

Mr. Frank D. Stockman, Vice President of Northern's Supply Division from 1965-1977, also testified on behalf of the Company. As Vice President, he was responsible for all phases of Northern's domestic gas supplies. (NNG-R-13 at 2) Mr. Stockman was involved in executing all of the Company's gas purchase contracts during the time when ARCs were first incorporated in Northern's contracts. He was also employed by the Company from 1956-1965 and 1977-1982 in other capacities. (*Id.* at 1-2)

Mr. Stockman stated that ARCs represented Northern's intent to pay the highest prices allowed by law or regulation. (*Id.* at 3-4) He also testified that the Company's intent was the same, regardless of the particular ARC wording employed, for all contracts he executed while serving as Vice President of Supply. (Tr. 2624) At hearing, Mr. Stockman displayed outstanding knowledge of Northern's use of ARCs and all related issues. He was a very credible witness for the Company.

Mr. Daniel Dienstbier succeeded Mr. Stockman as Vice President of Northern's Supply Division in 1977, and continued in that capacity through 1980. In addition, he has held positions for Northern's parent company and its subsidiaries. (NNG-R-14 at 1, 2) Mr. Dienstbier also testified that it was the intent and meaning of ARCs to entitle Producers to collect the maximum prices allowed by law. His statements were based on his prior personal

investigation in 1978, communications with the Supply Division staff in 1978, and on his involvement with natural gas purchase contracts while serving as Vice President of Northern's Supply Division. (*Id.* at 3)

Mr. Larry N. Reed, an employee of Northern from 1964-1980, also testified in support of the Company's position. From 1977 through 1979, Mr. Reed was General Manager of all Northern gas acquisitions in the lower 48 states and the Gulf Coast. In this capacity he reported directly to Mr. Dienstbier. (NNG-R-7 at 3) His primary responsibilities involved supervising all of Northern's gas buyers to make sure that they were informed of the Company's objectives, policies and negotiating strategies concerning gas purchase contracts. (*Id.* at 4) Many of these contracts contained ARCs. Mr. Reed, consequently, was very familiar with Northern's use of ARCs and the intended meaning of such clauses, especially immediately prior to and subsequent to passage of the NGPA. He testified that the Company's intent was for ARCs to provide for the payment of ceiling prices set by the federal government for the interstate market, regardless of whether Congress or a government agency set the price. (*Id.* at 6-8)

Northern also filed the testimony of Mr. Marvin Wilson. Mr. Wilson was employed by the Company from 1956-1984. Throughout this time he was directly involved in the acquisition of natural gas supplies. Initially, Mr. Wilson was an Assistant to the Gas Purchase Manager and later he became Director and Manager of Gas Purchases. From 1969-June 1984 he held a variety of management positions related to gas acquisitions. (NNG-R-8 at 2) During his entire tenure with Northern, Mr. Wilson was

personally involved in many major natural gas purchase contracts. (*Id.* at 4) Mr. Wilson testified that ARCs were included in contracts so that Northern could provide Producers with the federal interstate ceiling price. (*Id.* at 5, 7) Also, he explained that the purpose and intent of ARCs remained the same despite changes in ARC language. Furthermore, he agreed that ARCs triggered payment of ceiling prices no matter which federal government entity set that price. (*Id.* at 10-11) Finally, Mr. Wilson believed that Mr. McCarthy's 1978 memorandum accurately concluded that payments of NGPA prices were triggered by ARCs. (*Id.* at 13)

Mr. C. James Bulla was an employee of Northern from 1952-1981. Beginning in 1956, he became directly involved with the Company's natural gas purchase contracts. His duties with Northern included negotiating contracts as a gas buyer and later supervising other acquisitions personnel. (NNG-R-10 at 1, 2) The gas purchase agreements Mr. Bulla dealt with often contained ARCs. In his prepared direct testimony, Mr. Bulla stated that Northern's intent was to pay all ceiling prices and that Producers would automatically collect any changed ceiling prices irrespective of whether the Federal Power Commission (FPC), FERC or Congress established the new rates. (*Id.* at 4) In addition, Mr. Bulla received Mr. McCarthy's 1978 memorandum and agreed that it properly expressed the Company's intent.

Mr. William J. Poehling, who is presently an employee of Northern, also testified in this proceeding. Mr. Poehling commenced his employment with the Company in 1956 and worked directly with gas acquisitions from 1967 until April 1984. His job functions included negotiating natural gas contracts as well as supervising other Northern

buyers. (NNG-R-11 at 2, 3) Mr. Poehling testified that it was Northern's intent to pay interstate ceiling prices set by any federal authority, regardless of ARC language variations contained in Company contracts. (*Id.* at 6, 7) Mr. Poehling also explained that he and the buyers in his department agreed with Mr. McCarthy's conclusions in the 1978 memorandum.

Northern also filed the prepared direct testimony of Mr. Charles K. Dempster. Mr. Dempster worked in gas purchasing positions with Northern from 1975-February 1986. Among his duties was the negotiation of natural gas purchase contracts containing ARCs. His testimony corroborated the statements of the other Northern witnesses. He testified that it was the Company's intent to pay the maximum price allowed by law when it entered into contracts with ARCs. This included ceiling prices established by Congress instead of the FPC. (NNG-R-12 at 3) Mr. Dempster agreed with Mr. McCarthy's memorandum. (*Id.* at 5)

Mr. J. P. Guinane also offered testimony consistent with the other Northern witnesses. He has worked with Northern from 1954 to the present. From 1968-1979 Mr. Guinane was involved with purchasing activities for Northern and he is currently the Company's General Manager of Operations. From 1970-1977, when Mr. Guinane was Manager of Gas Acquisition, he was directly involved in negotiating natural gas purchase contracts containing ARCs, and also supervised Company buyers. (NNG-R-4 at 4-6) He testified that it was Northern's intent under ARCs to pay the interstate ceiling price allowed by law, including ceiling prices set by Congress. (*Id.* at 6-7) Additionally Mr. Guinane stated that all Company personnel who negotiated natural gas purchase

contracts were instructed to act in accordance with this intent. (*Id.* at 7)

Finally, Mr. Dennis F. Brune, an employee of Northern since October 1966, presented convincing testimony in support of the Company's asserted intent. He had held a variety of positions at Northern. From 1973-1978, as Supervisor of Regulatory and Pricing Control, Mr. Brune was responsible for determining the proper payments to be made to producers for natural gas charges. (NNG-R-22 at 2) From 1978-1982, Mr. Brune was Director of Contract Control. In this capacity he was responsible for deciding on contract payments, managing records of the gas purchase contracts, and developing and operating the natural gas contract data base. (*Id.*) Mr. Brune was a very credible witness who was familiar with Northern's intent and actions. His responsibilities, as well as contacts with Company personnel and producers, led him to state that "it was obvious that the intent of the area rate clause was to provide the highest price allowed by law." (*Id.* at 3) He further explained that the "highest price allowed by law" included prices set by any federal government entity. (*Id.*) Mr. Brune also expressed this intent in various correspondence. (See *Id.* at 4, NNG-R-23 (DFB-2); *Id.* at 6-7, NNG-R-24 (DFB-3); *Id.* at 19, NNG-R-33 (DFB-12))

Protestors unsuccessfully attempted to impeach Northern's witnesses. Generally, they attacked credibility by questioning witnesses on matters for which they were not presented and as to which no direct testimony was offered. For example, the PUCs brief on page 106 alleges that Mr. Stockman was declared incompetent during the hearing. (Tr. 2629) This is a gross distortion of the record. Counsel for the PUCs was examining Mr. Stockman on

the technical meaning of words used in ARCs, yet the witness was not responsible for drafting ARCs or deciding on what language should be used in the clauses. He was presented only to testify as to his belief of the Company's intent. Counsel for the PUCs seemingly would label witnesses incompetent when they cannot respond to questioning outside their universe of knowledge. This is an innovative but absurd argument. The Presiding Judge observed and assessed the credibility of all witnesses and finds all to have testified honestly, albeit some had less than complete knowledge of the area for which they were proffered. In those instances, however, those witnesses freely acknowledged their limitations.

The PUCs also attack Northern witnesses for not specifically *knowing* what Producers specifically intended when entering particular contracts with ARCs. (Staff Br. at 42, 45-46; PUCs Br. at 101) Northern witnesses generally *believed* that Producers intended to collect the highest prices allowed by law pursuant to ARCs. (*See* Tr. 936) They could not, however, absolutely know the intent.

Protesters further try to impeach Northern witnesses because they cannot recall details of negotiations, discussions and meetings. (Staff Br. at 43-46, PUCs Br. at 98, 99, 102 n. 173) PUCs question Mr. Guinane's credibility by stressing his inability to remember at which meetings ARC's meaning was discussed. (PUCs Br. at 99) Mr. Guinane testified that ARCs were discussed along with all other contract clauses during meetings. (Tr. 980) These conversations took place more than a decade ago when Mr. Guinane was involved with gas acquisitions for the Company. Although an inability to remember details will affect the weight given to witness testimony, it would be unusual for anybody to be capable of listing specifics from

discussions occurring after such a great period of time has lapsed. In this case, Northern witnesses consistently stated that the Company intended to pay ceiling prices pursuant to ARCs. Their inability in 1987 to recall particular conversations and statements made in the 1960s and 1970s does not negate the accuracy of their testimony.

Protestors try to impeach the statements of Mr. McCarthy by focusing on a small portion of his testimony and ignoring its clear meaning to the contrary. For instance, they claim that Mr. McCarthy's testimony is flawed because he agreed that it was *possible* that a member of Northern's management *could have* interpreted ARCs which only refer to the FPC as allowing only FPC price setting. (PUCs Br. at 110) (emphasis added) Mr. McCarthy's statement, however, was made in order to show how one *may* interpret an ARC by looking at the language itself. As was discussed previously, ARCs are to be evaluated by considering the language as well as all extrinsic evidence of intent. Northern's intent was known to Northern's personnel and to Producers, and clearly expressed in his 1978 memorandum which stated that the Company intended to pay ceiling prices pursuant to ARCs. This memo was circulated to 24 employees of Northern, who were natural gas buyers, attorneys, officers and contract administration personnel, and none of them indicated any disagreement with the memorandum's contents. (NNG-R-1 at 16)

PUCs also claim that certain witnesses lack credibility because their job responsibilities did not give them adequate knowledge to testify on Northern's intent. For example, they assail Northern's Vice President for Gas Supply, Mr. Stockman, because he did not read the

contracts he signed and never discussed the ARC intent with Producers. (PUCs Br. at 105, 106) Mr. Stockman, however, was very knowledgeable about Northern's intent because he was involved in shaping the Company's policy in regard to gas purchase contracts containing ARCs. The fact that he did not perform job tasks which the PUCs would have him carry out does not negate the strength of his testimony. The PUCs' assertions that Northern witnesses should have performed their jobs in a different manner has no bearing on the witnesses credibility. All Northern witnesses had adequate knowledge as a result of their positions at the Company to testify in regard to Northern's intent when using ARCs.

Protestors further attack Northern's witnesses by claiming that they have not consistently expressed a verbal formula of the Parties' intent. (PUCs Br. at 158) In essence, the PUCs claim that the Parties' position is ambiguous because witnesses used different words to describe ARC meaning. For example, some witnesses explained that ARCs provided for payment of the highest price allowed by *law*, and others used the words, highest price allowed by *federal regulation*. This is a preposterous argument. Both statements are sufficiently broad enough to allow triggering of NGPA ceiling prices, just as are other similarly worded phrases. Significantly, the Fifth Circuit found that an intent to pay NGPA ceiling prices was sufficiently described as one that would "permit escalation to the highest ceiling price permitted by governmental authority." *Pennzoil I* at 369. In addition, the D.C. Circuit found it sufficiently clear to describe an intent to pay NGPA ceiling prices as one that would "allow the contract price to float to the highest relevant

ceiling set by regulatory authorities. . ." *Associated Gas Distributors*, 810 F.2d at 229.

Finally, another impeachment tactic of Protestors was to ask questions about subject matter which was unrelated to the payment of NGPA ceiling prices, and then claim that since the witnesses' answers were not uniform, the witnesses were not believable. For example, the PUCs stress that witnesses gave differing answers regarding whether deregulated prices would be paid pursuant to ARCs. (PUCs Br. at 163-165) This line of questioning is meaningless since the issue here is whether NGPA ceiling prices were intended to be paid pursuant to ARCs. The fact that witnesses did not give a uniform answer about deregulated prices does not negate the overwhelming testimony by all witnesses that NGPA ceiling prices were intended to be paid under ARCs. What occurred, in fact, is that the witnesses stated ARCs are intended to define pricing under regulation, not deregulation. They attempted to answer Protestors' rather complex, hypothetical questions about situations not within the coverage of ARCs. Their answers are indicative of the confusion engendered by the questions themselves.

In sum, the testimony of Northern's witnesses clearly and conclusively supports Northern's claim that it intended ARCs to trigger payment of NGPA ceiling prices when the contracts at issue were entered, and that Northern believed Producers shared that intent. Protestors have failed in their attempt to impeach the witnesses' credibility through irrelevant and unfounded arguments.

### *B. Producers' Testimony of Intent*

Fifty-six Producer witnesses testified and were cross-examined during the 21 days of hearings. Although other producers proffered direct evidence, their testimony was not considered since they were not presented and cross-examined. As noted above, this additional direct evidence would have been cumulative.

Producer witnesses consistently explained that interstate pipelines were to pay the maximum lawful ceiling price established by federal authority pursuant to ARCs. (SUN-R-1 at 2, PZL-R-1 at 3; ROD-R-1 at 2; OCC-R-1 at 7-8; LW-R-1 at 7-8; KOC-R-1 at 3; NGOC-R-1 at 5) Many producers, in fact, recalled holding specific conversations with Northern to that effect. (ARI-R-1 at 1; TEX-R-2 at 9; TEX-R-14 at 6-7, DSE-R-1 at 3-4; IOC-R-1 at 3-5; CNR-R-1 at 5-6; CON-R-1 at 6). For example Mr. L. E. Hickman of Texaco U.S.A., who negotiated several natural gas sales contracts for his company, testified that he remembered discussing with Northern that it was Texaco's intent to collect the highest regulated price in the interstate market. (TEX-R-2 at 8, 9; Tr. 3677) For many producers, it was company policy to insert ARCs into gas sales contracts so that they could collect the highest prices allowed by law. (AHC-R-1 at 3; *See also* ARC-R-1 at 5; TEX-R-1 at 5; TEX-R-15 at 4; FIN-R-1 at 2)

The Producers also repeatedly explained that it was their intent to collect ceiling prices irrespective of which authority, such as an administrative agency or Congress, set natural gas rates. (ROD-R-1 at 5, 6; SOC-R-1 at 8; SRC-R-5 at 4-5; TEX-R-1 at 9) Producers did not believe it was necessary to list each and every plausible

pricing mechanism, and it was not possible that all contingencies regarding rate regulation could have been anticipated. (APC-R-1 at 5) As Mr. Douglas Bendell of Okmar Oil Company testified, he and a Northern representative would sit down and write language that they thought would, under all circumstances, provide that gas bought pursuant to ARCs would never be priced lower than the highest price allowed by law. (Tr. 5174, 5175). The ARC was to be an all-encompassing clause which automatically allowed price escalations when the applicable gas price increased.

Over time, as Producers and Northern continuously inserted ARCs into contracts, the use became so common that the Parties saw no need to discuss the meaning of the clause or its particular wording upon executing each contract. (PPC-R-1 at 5; AHC-R-1 at 4). Although ARC wording evolved as the regulatory environment changed, the clause was always intended to permit payment of ceiling prices. As Mr. Walter Cox of the Phillips Petroleum Company and Phillips 66 Natural Gas Company stated it was believed that there was no "special magic involved in a specific set of words because the intent under all the clauses was the same." (PPC-R-1 at 7)

Protestors attempt to impeach Producers just as they attacked the testimony of Northern's witnesses. First, they contend that Producers lack credibility because they did not *know* what Northern officials intended when entering ARCs. (PUCs Br. at 117, 186). Producers did generally *believe* Northern shared their intent, and as was previously discussed, this is certainly sufficient credible testimony. As was also explained *supra*, this belief was accurate.

Second, Protestors stress that the Producers did not recall details from discussions which took place more than a decade ago. (See PUCs Br. at 116-131). Again, this is but one factor to evaluate when determining witness credibility. In this case, however, almost all Producer witnesses presented very credible testimony which consistently explained that they intended to collect NGPA ceiling prices pursuant to ARCs. Such overwhelming testimony outweighs the Protestors' weak contention.

Third, Protestors attack certain Producer witnesses for being unfamiliar with regulatory markets. (Staff Br. at 99-100; PUCs Br. at 125-131) These Producers, however, only offered testimony in regard to the factual question of intent under ARCs. As the Producers stated on rebuttal brief, "[t]hey did not appear for purposes of taking a quiz on esoteric regulations Br. at 46). Their knowledge on regulatory matters is irrelevant to their testimony of intent.

Fourth, Staff raises a series of other failed contentions on brief. It attacks some Producer witnesses for generally not participating in, or being knowledgeable about, the contract negotiations process, and for not being employed by the producer when contracts at issue were executed. (Staff Br. at 98-99) Staff's contentions, however, are unsubstantiated and unpersuasive. Certain Producer witnesses had job responsibilities which required them to negotiate contracts and others did not. This does not mean that they cannot be familiar with their Company's intent through their other job responsibilities. Also, although some Producer witnesses were not employed by their Company at the time when some contracts were executed, they were still familiar with ARC intent through subsequent experiences. There was certainly substantial

Producer testimony on ARC intent which greatly preponderated over Protestors' attempts at impeachment. The Producers consistently explained that NGPA prices were to be paid under ARCs and their contract performance clearly supports this claim.

Finally, PUCs try to impeach Producer witnesses by alleging that their testimony was fabricated, false or misleading. (PUCs Br. at 171, 238, 239). These are extreme accusations which are as uncalled for as they are unfounded. Apparently, PUCs argue, when witnesses inaccurately respond to questions outside their scope of knowledge, they have devised a scheme to fabricate their statements. This line of argument is utterly inappropriate and is not an aid to furthering the ends of justice. PUCs use this premise to assert additionally that the statements of the Producers' cumulative witnesses would have been false, since their testimony was consistent with other Producer statements. (PUCs Br. Appendix at 3) This is a ludicrous argumnet which is based on an incorrect premise and has no legal basis.

In sum, the Producer evidence was credible and paralleled that of Northern. Their overwhelming testimony was that they intended ARCs to trigger payment of NGPA ceiling prices. Protestors have not introduced even a scintilla of direct evidence to the contrary. Producer testimony not only preponderated here, but did so conclusively. In seven years of discovery, Protestors have not found a single document or witnesses to support their contentions.

V. *Course of Dealing Under the Commercial  
and Regulatory Context*

As the Court explained in *Pennzoil II*, to determine proper ARC meaning extrinsic evidence of the commercial and regulatory context as well as the parties' course of dealing during the time when ARCs were negotiated, must be evaluated. A course of dealing is defined as a "sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct." U.C.C. § 1-205(1). Such evidence is important because the Order No. 23 series of cases are based on the relationship between private producer-pipeline contracts to the public regulation of the natural gas industry. *Associated Gas Distributors*, 810 F.2d at 228. During this proceeding, Northern and Producers introduced substantial evidence on course of dealing, commercial and regulatory context. It must be noted at the outset that Protestors presented no evidence regarding these factors.

As explained by Mr. Jack Earnest (IP-R-1), an expert witness presented by Producers, the Parties' use of ARCs was an outgrowth of both Commission regulations and competition in the natural gas industry. When ARCs were first used in the late 1960s and 1970s, the country was in a period of tight gas supplies. By using ARCs, interstate pipelines could offer Producers the highest federally authorized gas price so that they could compete with intrastate pipelines, who were not subject to federal regulation, for gas which was available. Mr. Earnest speaks from experience with both the pipeline and producer segments of the industry, the two segments involved in negotiating and administering gas

supply contracts and their ARCs. Mr. Earnest is found to be completely knowledgeable and credible.

Initially, the Commission regulated the sale of gas by the producers through an individual cost-of-service formula. *Pennzoil II* at 1132 n.5. This approach was ultimately unworkable, and consequently was replaced by a method whereby gas sales within geographical areas were subject to Commission-set ceiling prices. *Id.*; See *In re Permian Basin Area Rate Case*, 390 U.S. 747 (1968). (NNG-R-1 at 9-10) Thereafter, the Commission abandoned this approach and established national ceiling rates. In order for ceiling rates to apply to a particular transaction, jurisdictional gas must have been sold at a price authorized by the contract in issue. See *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958). Therefore, the individual contracts still established prices, but these prices were subject to the established ceiling rates. *Pennzoil I* at 372.

The Commission promulgated further rules that required strict compliance with its pricing guidelines. On March 31, 1961, the Commission stated that contract clauses establishing price changes would be inoperative unless they tracked certain enumerated provisions. Order No. 232-A. 25 FPC 609 at 610 (1961). In 1962 the Commission amended that order, which is still in effect, to provide that the entire contract would be rejected if it contained an impermissible price change provision. Order No. 242, 27 FPC 339 (1962), *vacated Texaco, Inc. v. FPC*, 317 F.2d 796 (10th Cir. 1963 *reversed sub nom*, *FPC v. Texaco Inc.*, 377 U. 33 (1964).

The Commission amended its regulation again in 1966 by allowing parties to include language in gas purchase contracts which evolved into what is now commonly

referred to as an area rate clause. *See* Order No. 329, 36 FPC 925 at 927 (1966). Specifically, the 1966 amendment allowed for:

Provisions that permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of the gas involved. *Id.*

Order No. 329 was codified in 18 C.F.R. § 154.93, and remains to this date.

Area rate clauses are a type of indefinite price escalator clause. Indefinite price escalator clauses permit automatic upward price adjustments upon the occurrence of some specified event. *Pennzoil I* at 366. In the past the FPC has permitted ARCs, with language that closely tracked § 154.93, to escalate contract prices to national ceiling rates, ceiling rates for qualifying sales of small producer gas, rollover contract gas, and flowing but unregulated gas. *See Id.* at 367.

Since ARCs would be inoperative unless they closely followed Commission regulations, pipelines and producers initially drafted the clauses so that they would have conforming provisions. (Tr. 815; IP-R-1 at 11, 12) The Court noted in *Pennzoil I* at 389, that it was reasonable for an ARC tracking Commission regulations to allow for collection of NGPA prices.

Many ARCs used in Northern's contracts mirrored the language which was permitted by Commission regulations. Some of the clauses, however, did not track the regulation but the Commission nevertheless accepted them for filing. (*See* Tr. 816) In all instances, Northern and Producers intended ARCs to trigger payment of interstate ceiling rates, including NGPA prices, irrespec-

tive of variations in the language inserted by the Parties. (Tr. 2860; NNG-R-1 at 14; NNG-R-11 at 5-6; NNG-R-10 at 8) Such an intent was not unreasonable as the Court found in *Pennzoil I*, given the overwhelming consistent testimony by the Parties to that effect, and their Performance under these agreements.

Northern's claimed intent is also supported by the correspondence which the Company sent relating to its gas purchase contracts. When the NGPA was enacted, Northern received inquiries in regard to whether ARCs would permit escalation to NGPA ceiling prices. On each occasion, the Company responded that such an escalation would be permitted. For example, during contract negotiations with MAPCO, Inc., Mr. Brune informed MAPCO by letter that under ARCs MAPCO "would be able to collect the highest price if regulation of gas under the contract continues . . . ." (NNG-R-23)

The course of dealing, and the regulatory and commercial context in which negotiations were conducted clearly supports the Parties' contention that they intended ARCs to authorize and require payment of NGPA ceiling prices. As was discussed above, the parties intended ARCs to allow interstate pipelines to pay, and producers to collect, all ceiling prices pursuant to federal regulation. Such a regulatory framework allowed interstate pipelines to compete for the limited gas supplies available. ARCs also enabled interstates to lock into long-term contracts to secure an adequate gas inventory and alleviated uncertainties among producers about collection of price increases resulting from subsequent regulations. This was especially important since contracts could not be terminated without prior Commission abandonment authority.

Protestors have unconvincingly argued various theories in opposition. First, they assert that the Commission's regulations imposed a limited concept such that contemplating collection of ceiling prices, other than specific area or national rates, established by law was a "prohibited intent." (PUCs Br. at 289) This argument is nothing more than a collateral attack on Order No. 23, and, in any event, is absurd on its face. Nothing prohibited any parties from contracting for whatever price they intended. The law and Commission regulations only limited that which could be paid and collected. If the Parties intended payment to escalate to an unknown future price, that escalation could be effective when the future price became authorized. In *Pennzoil I*, the Fifth Circuit explained that ARCs which tracked § 154.93 "could constitute sufficient authority to collect NGPA prices." *Pennzoil I* at 389. Protestors have failed to introduce even a scintilla of evidence in support of their "limited" intent theory. Not a single witness agreed with Protestors' characterizations of their "limited" intent. The argument is without support or merit.

Second, the PUCs argue that the Commission acted to somehow prohibit ARCs calling for the highest price allowed by law when they addressed certain comments filed by Phillips Petroleum Company in Order No. 329, 36 FPC 925, 926 (1966). (PUCs Br. at 283-284) The PUCs' position is a complete mischaracterization of the comments and the Commission's response. Phillips commented on two concerns in regard to the Commission's rulemaking to amend Section 154.93: that the Commission's regulation limited price escalation only to the just and reasonable *area* rate; and that the Commission's regulation appeared to be inconsistent with

provisions of Opinion No. 468, which allowed producers to file for both special relief and area rates. 36 FPC at 926. The Commission rejected the first comment because it was an objection to the area rate approach adopted in Opinion No. 468 [34 FPC 159], and all such arguments were already fully addressed and rejected in that proceeding. In regard to the second argument, the Commission stated that the current rate would not preclude filings for special relief from the area rate established in the Permian Basin area rate proceeding. *Id.* There was no mention that the Commission intended to prohibit collection of NGPA ceiling prices. It only intended to preserve its area rate procedure by not altering the proposed regulation.

Third, Protestors assert that ARCs were intended to have a limited intent since there was a lack of buyer competition in the natural gas industry. (PUCs Br. at 302, 309) The PUCs introduced no direct case to support their view of the competitive environment. Also, they cite certain witnesses' statements out of context in attempted support of their claim, yet fail to address the overwhelming evidence indicating that competition was, indeed, a key factor which allowed producers to demand payment of all federal ceiling prices pursuant to ARCs. For example, on page 309 of their brief, the PUCs assert that Mr. Bulla's statement that Northern did not buy much gas in competition with intrastates proves a lack of competition. This is a distortion of Mr. Bulla's overall testimony. Both in his prefiled direct testimony and at hearing he explained that intrastate competition was an important part of increasing interstate prices. (Tr. 1690; NNG-R-10 at 4)

As was recognized by the Commission:

[t]he excess of current demand for natural gas over the current supply became apparent in the latter part of the 1960s and increased progressively through the 1970s.

Gas Research Institute, Opinion No. 11, 2 FERC ¶ 61,259, at p. 61,616 (1978). By using ARCs, interstate pipelines could pay the highest price permitted by federal regulation, allowing them to compete for the limited gas supplies with intrastate pipelines. If Northern did not include ARCs in its contracts, it would have been difficult to establish purchasing agreements with Producers, and this would have led to serious gas supply difficulties for the Company. (See NNG-R-8 at 7)

Fourth, the PUCs claim that since ARCs were used in contracts when gas was already dedicated to Northern, such as in rollover contracts and in "upgrade" amendments, that the clauses were used when there was no such need to pay higher prices. (PUCs Br. at 310) There was substantial evidence, however, that ARCs were provided in rollovers and contract amendments in exchange for a new dedication or additional development of the existing dedicated acreage. (Tr. 1037, 1033, 1205, 1323-1324, 1335, 1410-1411) By offering ARCs as an incentive, therefore, Northern was able to compete with other pipelines and acquire adequate long-term dedicated gas reserves. Also, the issue here is not whether Northern prudently used ARCs in its contracts, but only what they intended ARCs to mean.

Fifth, Protestors contend that because Northern's Mr. McCarthy stressed that careful drafting of contract clauses was important, that ARCs could not have an expansive meaning to cover prices set by an authority other than

FERC or the FPC. Although many ARCs do not mention Congress or the NGPA, the lack of reference was not because the Parties did not intend ARCs to be triggered by NGPA pricing. Instead, it was because the Parties expressed themselves in accordance with the known regulatory structure at the time ARCs were executed. (See generally TEX-R-1 at 9; CHV-R-1 at 9; AHC-R-1 at 4; SPI-R-1 at 7; EXX-R-1 at 12; SRC-R-3 at 4) At the time of contract execution, they intended ARCs to be triggered by any federally set ceiling prices, but only contemplated rate setting by the FPC or the FERC. The fact that an ARC may not mention legislatively set rates does not preclude the triggering of such prices. As the Court stated in *Pennzoil I* at 389, it is not unreasonable for ARCs closely tracking Commission regulations to trigger payment of NGPA prices. In addition, as was believed *supra*, the Parties reasonably believed that ARCs would be inoperative if they did not track at least generally the language used in the Commission regulation, which did not and still does not refer to Congress or the NGPA.

Sixth, Protestors have also theorized that since Producer and Northern witnesses did not agree that collection of "special relief prices" would be collectable pursuant to ARCs, that this somehow refutes the contention that ARCs allowed collection of NGPA ceiling prices. (Staff Br. at 68; PUCs Br. at 171-175) This is another of PUCs' absurd arguments. Special relief is a procedure initially used by individual producers, who contracted for gas at above-ceiling rates, to obtain higher gas prices by showing that out-of-pocket production costs exceeded revenues under their current area rate. Opinion No. 468, 34 FPC 159, 226 (1965). As time passed, these procedures were also used for obtaining higher prices for specific new drilling programs on previously dedicated acreage.

Significantly, special relief rates were applicable only to individual producers who followed proper procedures, and only when above-ceiling prices were in effect pursuant to an individual pipeline-producer agreement. ARCs only apply to automatic escalation of federally established ceiling prices. Therefore, rates set under special relief procedures are outside of the scope of pricing pursuant to ARCs. It should be noted that there never was a designation of a special relief *price*. There were special relief procedures whereby relief *from* ARC pricing could be obtained. Protestors confuse and distort this distinction.

Similarly, PUCs questioned witnesses in regard to recovery of prices set by "optional procedures." This was a method whereby producers could obtain higher rates outside the generally-applicable rate structure by "one-shot" Commission approval pursuant to Sections 4 and 7 of the Natural Gas Act. Order No. 455, 48 FPC 218, *reh'g denied*, Order No. 455-A, 48 FPC 477 (1972), *modified*, 502 F.2d 461 (1974), *rev'd* 424 U.S. 494 (1975). Under this policy, two of the Commission's requirements were that the contract in question not contain an indefinite pricing clause, and that an acceptance of the "one-shot" certificate would waive all rights to future rate increases. Therefore, this procedure was not even available to parties with contracts containing ARCs. Also, since rights to future rate increases were waived if the "one-shot" certificate was accepted, this is clearly contrary to the operation of ARCs, which allow for automatic collection of escalated prices. Optional procedure pricing is, consequently, unrelated to the meaning of ARCs.

Protestors also argue that Northern could not have had an intent to automatically pay ceiling prices because many ARCs stated that Northern had a right to intervene when

a new ceiling rate was established. (PUCs Br. at 148-152) This contention is related to a two-part theory: 1) that inclusion of this right shows an intent by Northern not to pay Congressionally set rates; and 2) that the rates would not be effective unless established in an administrative proceeding where Northern had a right to intervene, and that since Congress established NGPA prices, ARCs do not apply to NGPA rates. PUCs fail to offer any support for these assertions. The evidence shows that Northern included intervention rights in its clauses because some producers were not aware that pipelines could intervene in area rate proceedings, and by stating this right Northern sought to avoid potential breach of contract actions if intervention were exercised. (Tr. 3031) There is no indication that Northern ever protested payment of new ceiling rates, but only that this right was reserved. In regard to the second part of the theory, a right to intervene does not exist only in administrative proceedings. It could involve many procedures such as providing oral testimony, or even offering written comments to a Congressional committee. There was no indication that the right to intervene was a pre-condition to paying escalated rates at all, and certainly not that the right would be limited to administrative procedures. The Parties themselves disclaimed such an intent. PUCs also speculate that Northern negotiated to replace a redetermination clause with an ARC under a contract with MAPCO, so that it could intervene in proceedings to increase rates and thereby limit price escalations. (PUCs Br. at 281) The evidence clearly shows, however, that by adding ARC language Northern allowed MAPCO "to collect the highest price if regulation of gas under the contract continue[d] . . ." Also, in regard to the requirement that ARCs only apply to administratively-set gas price increases, the FERC

has noted that it will not invalidate a contract clause merely because Congress set the regulated rates when administrative action was originally contemplated by the parties. Opinion No. 77, 10 FERC ¶ 61,214, at p. 61,399 n.15.

Finally, PUCs claim that Northern could not have intended to enter ARCs allowing for collection of NGPA ceiling prices, because they did not intend to contract for unmarketable gas. (PUCs Br. at 321-325) PUCs argue that since NGPA prices were eventually raised to prices above unregulated rates, the gas became unmarketable and caused Northern to lose gas load. (PUCs Br. at 325) Marketability of gas, however, is not measured by evaluating gas purchase contracts individually. To determine whether a pipeline's gas is marketable, the Weighted Average Cost of Gas (WACOG) and the pipeline's overall "rolled-in" gas must be marketable. PUCs do not address problems with Northern's WACOG or its "rolled-in" gas prices, and offer no method of determining marketability. They merely state the obvious, that no company intends to acquire an unmarketable product. Even if Protestors could prove that the gas was unmarketable, however, this would not change Northern's intent when the ARCs were entered into. Although the results of contract performance may not ultimately turn out as expected, this does not affect the contracting parties' initial intent. The contracting intent was to include ARCs automatically effecting regulated price escalations. The *motivation* for doing so was for Northern to obtain a marketable, competitive product, and for the Producer to obtain the highest permissible price. Risks thus were allocated. Subsequently, as discussed *infra*, Northern became dissatisfied with that which it had undertaken. That dissatisfaction, however, cannot alter its original intent.

Staff argues that Northern had a policy not to "grant" ARCs unless economic hardship was shown by the producer. (Staff Br. at 53-55) This is a distortion of the record. Staff cites correspondence from Texaco Inc. to Northern, and from Northern to Cities Service Oil Company to support its view. These letters do discuss the problems with the then-existing low gas prices. There was no showing, however, that the low prices induced Northern to agree to ARCs. Indeed, as Staff pointed out on brief, Northern sought to pay the lowest reasonable price for gas. (Staff Br. at 52) Northern's use of ARCs was actually induced by the need to assure long-term gas supplies for its customers. As was stated in the Texaco letter to Northern,

... [q]uite frankly the price increases are in the best interest of your customers because they serve to extend the economic life of the leases thus avoiding premature abandonment and bringing additional gas to market.

(P-R-29) In any event, regardless of Northern's reasons for entering ARCs, the Company's intent was to pay any federally authorized ceiling price under the clause, and that is the issue that we are concerned with here.

In conclusion, the Parties' course of dealing under the commercial and regulatory context indicates that they intended ARCs to trigger payment of NGPA rates. Commission regulations and market forces had a great impact on the Parties' initial use of ARC language, and their subsequent dealings pursuant to the clause. Protestors' arguments to the contrary are meritless and are largely based on distortions of both the record and precedential authority.

## VI. *Course of Performance Under the Commercial and Regulatory Context*

Under Section 2-208(1) of the U.C.C., course of performance is defined as follows:

Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

Course of performance evidence tends to be indicative of actual contract meaning. As was stated by Professor Williston: "[t]he practical construction placed upon a contract by the parties themselves constitutes the highest evidence of their intent that whatever was done by them in the performance of the contract was done under its terms as they understood and intended same should be done." 4 Samuel Williston. *A Treatise on the Law of Contracts*, § 623 (3d ed. 1961)

During this proceeding, Northern and Producers have presented substantial testimony in regard to the Parties' course of performance pursuant to the ARCs in issue. As is the situation with all other issues, Protestors have not presented a scintilla of affirmative evidence to support their contrary theories. A proper understanding of the Parties' course of performance requires an analysis of their actions under the commercial and regulatory environment in the following three time periods: 1) pre-NGPA; 2) from December 1, 1978 to January 1, 1985; and 3) from January 1, 1985 to the present.

### *A. Pre-NGPA Course of Performance*

The Parties' course of performance prior to enactment of the NGPA shows that both Northern and Producers treated ARCs as triggering payment of the applicable ceiling price established by federal regulation. (CHV-R-1 at 10, 13; EXX-R-1 at 10; IP-R-3; Tr. 2797) Such performance was consistent with their intent under the regulatory context as will be shown below.

The regulatory scheme which was developed by the FPC/FERC shows that interstate pipelines are to automatically pay the highest applicable rates under the area rate clause. When the Commission adopted a series of pre-NGPA ceiling prices, those rates were consistently paid, although the ARCs typically tracked Commission regulations calling for payment of "area ceiling rates". (emphasis added) For example, the FPC allowed producers and interstate pipelines to rely on ARCs as authority for payment of nationwide ceiling prices, which were established in 1974. *Pennzoil I* at 367. The Commission also authorized contracting parties to pay ceiling prices established based on the concept of vintaging gas as "old" or "new", pursuant to the clause. See Order No. 451, *FERC Statutes and Regulations* ¶ 30,701, at p. 30,200 n.14 (1986). Furthermore, ARCs have triggered payment of ceiling prices set for small producers. Opinion No. 742, 54 FPC 853, 858 (1975). In addition, the Commission allowed ARCs to provide authority for prices of "old" gas, gas flowing prior to January 1, 1973, to escalate to nationwide ceiling rates established for "new" gas, and this pricing structure was approved by the Fifth Circuit Opinion No. 749, 54 FPC 3090 (1975); *Shell Oil Company v. FPC*, 520 F.2d 1061, 1077 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976). The

Commission has also permitted escalation to new ceiling rates established for rollover contract gas and for sales of flowing but undedicated gas pursuant to ARCs. See *Pennzoil I* at 367. Lastly, the Commission has approved payment of nationwide ceiling price escalations set for gas flowing subsequent to December 31, 1974, under the clause. Opinion No. 770, 56 FPC 509, 516, 578-584, *modified*. Opinion 770-A, 56 FPC 2698 (1976). Significantly, these prices were based on both cost and non-cost factors, and were paid irrespective of the ARC referring to payment of "area ceiling rates."

The evidence shows that Northern and Producers consistently relied on this pattern of regulation as authority for triggering of ceiling prices under ARCs, including NGPA rates. (NNG-R-1 at 12). Both Northern and Producers testified that, consistent with those Commission rulings, nationwide ceiling prices, small producer prices and ceiling rates established for "old" and "new" gas were paid under area rate clauses.

Protestors advance two arguments in reply to the Parties' contentions on pre-NGPA course of performance. First, as was discussed in Part V, they claim that since Northern did not pay rates established by special relief procedures without a contract amendment, it did not intend to pay NGPA prices pursuant to ARCs. (See PUCs Br. at 172-175; Staff Br. at 62) As was discussed in Part V, special relief procedures allowed for payment of above-ceiling prices and were set entirely outside the realm of ARC operation. These prices were not part of the Commission's scheme of establishing ceiling rates. Furthermore, if Northern intended ARCs to provide authority for payment of special relief rates, there certainly was no need for them to amend contracts to permit payment of such rates.

Second, PUCs contend that since the Parties were limited to following Section 154.93 when drafting ARCs, that the clause “merely provided for [payment of] prices found ‘just and reasonable’ under the Natural Gas Act in area or nationwide rate proceedings.” (PUCs Br. at 295) Any ARCs referring to allowance of “just and reasonable” rates, however, were only phrased this way to reflect accurately the then-existing regulatory framework. When those clauses were entered, the Parties intended ARCs to allow for payment of the highest ceiling prices, yet only contemplated price setting under the Natural Gas Act. This was certainly proven by the manner which Commission rulings allowed for payment of various ceiling prices under the clauses, regardless of whether the ARC specifically referred to payment of these rates, as was discussed above.

Protestors also tangentially infer that ARCs only authorized payment of rates established in formal evidentiary hearings. The Commission has established and the Parties have paid, however, ceiling prices set by rulemaking proceedings and through approval of settlement agreements. *See Shell Oil Company v. FERC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976); *See, e.g.,* Opinion No. 598, 46 FPC 86 (1971).

The Parties’ evidence of pre-NGPA course of performance under the commercial and regulatory context clearly demonstrates that it was intended for ARCs to trigger payment of all prices established pursuant to the pattern of ceiling rates set by federal regulations. The evidence indicates that such rates were to be paid regardless of whether: 1) they were cost-based; 2) they were set in a rate proceeding, rulemaking or settlement; or 3) the ARC at issue only referred to the setting of “area ceiling rates.” (See NNG-R-1 at 11).

*B. Course of Performance From December 1,  
1978 to January 1, 1985*

- In the fall of 1978, upon enactment of the NGPA, Northern determined that its contracts containing ARCs required payment of NGPA ceiling prices effective December 1, 1978. This decision was based on the Company's intent when it entered the clauses in issue.

Mr. Dienstbier, the Vice President of Northern's Supply Division, conducted an investigation in 1978 to evaluate whether payments of NGPA ceiling prices were intended and authorized under the Company's ARCs. He investigated this matter because, having been in the gas supply division for only one year, he wanted to verify the decision with more experienced gas acquisitions personnel. (Tr. 2287) During the investigation, Mr. Dienstbier consulted with members of the Supply Division staff, Mr. Reed, Mr. Guinane and Mr. Poehling, as well as with the Company's attorney, Mr. McCarthy. (Tr. 2289) Each confirmed that Northern intended through its ARCs an obligation to pay NGPA ceiling prices. Based on the investigation, Mr. Dienstbier recommended that Northern pay NGPA ceiling prices. (Tr. 2284, 2359) As was discussed earlier, Mr. McCarthy also made such a recommendation in his November 6, 1978 memorandum. Mr. McCarthy's position was based on his review of ARC language, the Parties' course of performance, commercial and regulatory circumstances and discussions with Northern personnel who confirmed his view. (NNG-R-1 at 8-9; Tr. 763-764; See Tr. 754; NNG-R-2) His memo was circulated to twenty-four company employees involved with gas acquisitions, none of whom expressed disagreement with his conclusions. (NNG-R-1 at 16) Northern's

ultimate decision to pay NGPA rates was based on these conclusions in addition to the recommendation of Mr. Stockman (Tr. 2372).

The evidence shows that Northern consistently paid NGPA ceiling rates from December 1, 1978 until 1985 under the contracts in issue. An April 9, 1979 memorandum from Mr. Dennis Brune, who was responsible for determining proper payments under Northern's natural gas purchase contracts, states that the Company was to finally determine the ceiling prices for NGPA Sections 102, 103, 107 and 108 gas which became effective on December 1, 1978, by June 1, 1979. (NNG-R-31; NN G-R-22 at 17-18). Northern witnesses consistently testified that such prices were paid. For example, Mr. Brune noted that the Company paid NGPA rates from the outset, although such a position was initially contrary to that stated by the FERC. (*See* NNG-R-28) Based on discussions with Producers and Northern personnel, Mr. Brune recognized that ARCs "obviously" obligated the Company to pay NGPA ceiling prices. (NNG-R-22 at 1-2) In addition, Producers have harmoniously testified that Northern paid NGPA prices as of December 1, 1978. (AND-R-1 at 2; APC-R-1 at 6; BHP-R-1 at 5; CPC-R-1 at 5-6; TEX-R-16 at 8; CHV-R-24 at 2-3)

Although the Parties' course of performance as of December 1, 1978, clearly shows that they intended ARCs to trigger payment of NGPA prices. Protestors contrive a series of unfounded arguments in their rebuttal briefs. First, Staff contends that Northern's intent to pay NGPA ceiling prices did not originate until its policy was formulated at an October 1978 meeting among Northern personnel. (Staff Br. at 47-49) Staff claims that the Company's intent in 1978 was separate from that existing

when ARCs were entered into. All of the proffered evidence, however, indicates that a contrary scenario existed. Mr. McCarthy's memorandum and the overwhelming testimony show that Northern's decision to pay NGPA prices was based on its original intent, and was not separately formulated. In fact, the purpose of the Company's fall meeting was to determine whether NGPA payments would be consistent with its *initial* intent.

Second, Protestors theorize that Northern's payments of NGPA ceiling prices were conditional because in correspondence the Company explained that Producers were under a refund obligation. (PUCs Br. at 336-337) The refund obligation was imposed for two reasons: 1) The Commission's Order No. 23 procedures specifically provide that payments by a pipeline were subject to refund. Order No. 23, Docket No. RM79-22, *FERC Statutes and Regulations. Regulations Preambles* 1977-1981 ¶ 30,040, at p. 30,316 (1979); and 2) because of the uncertainty existing in regard to Commission regulations allowing ARCs to trigger payment of NGPA ceiling prices. Northern's insistence on a refund obligation, therefore, was clearly based on the impact of Commission regulations. There was no evidence submitted to show that the payments were conditional pending Northern's decision on its ultimate intent. The Company's intent was formed when entering ARCs and did not vary regardless of FERC rulings, as was noted above.

Third, Protestors argue that since Northern required consideration from Producers before it would agree to amend its ARCs to provide expressly for payment of NGPA prices, this shows the Company's initial intent under unamended clauses did not trigger payment of

NGPA rates. No evidence or legal precedent, however, supports such a finding. Northern believed unamended ARCs allowed for payment of NGPA prices and did not require reference to the NGPA before making such payments. The overwhelming testimony in this case shows that ARCs were only modified at the insistence of Producers, to alleviate any doubt they might have that NGPA rates were authorized by the clause, especially in light of the Commission's original conclusion, since abandoned, that specific NGPA reference was necessary. (See Tr. 3920-3921) Also, payment of consideration was required from Producers because this had been the policy of Mr. McCarthy for *all* contract amendments. (Tr. 791)

Fourth, Staff and PUCs attack the Parties' claimed intent because Northern would not amend its ARCs to include negotiated contract language under Commission regulation 271.702(a)(1), which allows payment of NGPA Section 107 tight sands gas incentive prices, without first receiving consideration. (PUCs Br. at 377-380; Staff Br. at 60-61) (PUCs focus on two factors: 1) some Producer witnesses believed Northern should have provided amendments without consideration (PUCs Br. at 133); and 2) statements made at an officers meeting on October 20, 1981, showed a contrary intent. (See P-R-12)

Whether or not the Parties intended to pay tight sand prices, however, is irrelevant here. As Sun Exploration and Production Company convincingly explained on brief:

PUCs conveniently disregard the fact that "qualification" for the NGPA section 107(c)(5) maximum lawful price requires a negotiated contract price. By Commission regulation, an area rate clause

cannot authorize collection of the tight sands prices without qualification through a negotiated contract price, which price supercedes and nullifies any reliance upon an area rate clause as a source of contractual authority to collect the maximum lawful price for that category of gas. The whole issue is, for Protestors, a nonstarter.

(Producers' Rebuttal Br. at Appendix 7); *See Pennzoil v. FERC*, 671 F.2d 119, at 123 n. 14 (5th Cir. 1982); *See generally Midwest Gas Users Association v. FERC*, 833 F.2d 341 (D.C. Cir. 1988). Clearly, since ARCs apply to automatic price escalations and Section 107 tight sands gas pricing is based upon a negotiated gas price, tight sands pricing is not within the realm of NGPA prices automatically triggered by ARCs.

Furthermore, the October 20, 1981 meeting minutes do not negate Northern's intent. The minutes show that the Company's position on tight sands gas differed from its intent under ARCs and that it would *consider* changing the clause's language only if pressured by a producer. (P-R-12) (emphasis added) In sum, Northern's position regarding tight sands gas is unrelated to the issue here and, in any event, does not indicate a contrary intent by the Company.

Fifth, Protestors assert that Northern did not intend to pay NGPA Section 108 stripper well gas prices pursuant to ARCs. (Staff Br. at 61; PUCs Br. at 463-464) As support for this claim, PUCs point to evidence that Northern sought to eliminate payments of Section 108 rates in post-NGPA agreements. (See P-R-37) There is no indication, however, that Northern pursued any action to cease payments of such prices under ARCs which they already entered into. Indeed, if the Company

had no such obligations under pre-existing ARCs, there would have been no need to specifically exclude that category of gas in post-NGPA contracts.

Also, Staff argues that Northern could not have intended to pay the highest prices allowed by law, since it inserted "Minneapolis Clauses" to restrict such payments. (Staff Br. at 59) Minneapolis Clauses were used by Northern subsequent to the NGPA to place some limit on the Company's obligation to pay NGPA rates pursuant to ARCs. Basically, the clause limited the application of ARCs to competitive fuel pricing. There would have been no need to utilize such a restrictive clause, however, if Northern could have limited gas prices under the ARC itself. Indeed, Northern's attempts to seek some price protection under ARCs shows that the clause did not allow the Company to limit gas prices, but that separate action was required to obtain price relief.

Sixth, Protestors contend that payment of NGPA prices was not intended because Producer witnesses could not agree whether production-related costs under Section 110 of the NGPA were payable pursuant to ARCs. (PUCs Br. at 177-179; Staff Br. at 61) This argument, similar to the majority of Protestors other assertions, is irrelevant to this case and lacks evidentiary and legal support. The Commission has established a separate procedure too allow parties an opportunity to prove whether or not an ARC permits recovery of delivery allowances under NGPA Section 110. See Order No. 473, *FERC Statutes and Regulations* ¶ 30,747 (1987). As was noted at the hearing, the collection of production-related costs does not reflect directly upon the Parties' intent relating to generally-applicable ceiling

prices for gas. (Tr. 4158-4163) The issue here involves the cost of gas, in particular, payment of NGPA gas prices. Payment of production-related expenses is not a gas cost, and, therefore, is outside the scope of this case.

Seventh, Protestors question Northern's intent by claiming that if the Company intended to pay the highest price allowed by law, it would pay Order No. 451 prices under the ARC. (Staff Br. at 61-62) *See* Order No. 451, *FERC Statutes and Regulations* ¶ 30,701 (1986). Similar to NGPA Section 107 tight sands prices, however, certain procedures must be followed before such rates can be paid. The contracting parties, under Order No. 451 procedures, have an opportunity to renegotiate their contract to obtain the alternative ceiling rates, regardless of the parties' initial intent under the particular ARC. Since both parties must renegotiate to allow these prices to apply, the rates are unrelated to automatic price escalation provisions, the issue here.

Finally, Protestors attempt to attack Northern in this case by distorting certain findings and statements from Phase II of this proceeding. (PUCs Br. at 205, 229, 333, 380-381) Phase II involved a dispute between Northern and a producer, Cities Service Oil and Gas Corporation, regarding whether two 1963 natural gas purchase contracts contained ARCs. 31 FERC ¶ 61,011 (1985), *reh. denied*, 34 FERC ¶ 61,375 (1986). In that case, Northern argued that Cities was not entitled to a rate increase because the clauses in issue were not ARCs at all, but rather, were fixed-price contract clauses. The issue of intent was only explored in regard to whether the clause was intended to be an ARC. It was ultimately found that the clauses were not ARCs.

In Phase II, Cities asserted that the Court should not

consider extrinsic evidence since the clauses were clearly ARCs. Protestors, therefore, argue that in this case Producers believe the contracts in issue should be interpreted without evaluating the extrinsic evidence. (PUCs Br. at 205, 229) In Phase II, however, Cities argued the dispute centered on ambiguity in the words contained in the clause. Northern argued there was no ARC in the contract. In this proceeding, we are concerned with the meaning intended to be placed on the clauses in light of the Parties' performance and dealings, as well as the commercial and regulatory environment. The Parties admit that the clauses being construed here are ARCs. Therefore, any extrinsic evidence submitted regarding the Parties' intent must be reviewed. Protestors' reliance on statements and findings in Phase II is misplaced and will be given no weight here.

Similarly, both Staff and PUCs rely on, and distort statements in, a proposal exhibit which was identified but not received, asserting that Northern previously expressed a different intent under ARCs in *Premier Resources Ltd. v. Northern Natural Gas Co.*, 616 F.2d 1171 (10th Cir. 1980). (See P-R-56) In a *Premier* deposition, Mr. Stockman of Northern explained that ARCs required payment of rate increases set by the FPC, and, therefore, Protestors argue that only FPC/FERC price escalations were intended to be paid pursuant to the clause. (See P-R-77) When Mr. Stockman was deposed, however, he never explained that *only* FPC rates should be paid. Also, at the time, NGPA prices were not in existence, and the FPC was the only authority establishing gas rates. Therefore, it was impossible for the Company to have specifically considered paying Congressionally set prices. It was, however, within its intent to pay all applicable

ceiling rates. Furthermore, Protestors' reliance on P-R-56, which was not made part of the record, is highly inappropriate and such argument will not be considered. It is mentioned here only to foreclose the later argument that something in Protestors' briefs went unnoticed.

The course of performance evidence overwhelmingly demonstrates that Northern and Producers intended the ARCs in issue to trigger payment of NGPA ceiling prices. NGPA ceiling prices were paid by Northern as of December 1, 1978, and as the testimony and documentary evidence clearly indicates, such payments were made because it was consistent with the Parties' intent when entering the contracts at issue. The arguments raised by Protestors are, for the most part, irrelevant, and in their entirety, unpersuasive.

*C. Course of Performance From January 1, 1985 to Present*

In 1984, Northern sought to begin paying prices lower than the NGPA ceiling rates required by its ARCs. Northern tried a series of methods to obtain lower prices such as seeking price-limiting amendments to contracts containing ARCs (P-R-62; P-R-63; P-R-64; Tr. 2204, 2418-19, 5042, 5044), and invoking other contract provisions such as those permitting reduction of purchases. (Tr. 4996-98, 4791, 5632) Beginning January 1, 1985, Northern began paying these lower prices (Tr. 2419); in some cases the Company breached the pricing terms of its gas purchase agreements (Tr. 5304, 5200-01).

Protestors assert, however, that Northern paid less than NGPA ceiling prices as of January 1, 1985, pursuant to the ARCs in issue. (PUCs Br. at 468 This argument is an attempt to support Protestors' theory

that Northern only intended to pay what they term market prices for natural gas supplies.

The problem with this contention, as is the problem with all of Protestors' theories, is that it is wholly speculative and unsupported by any evidence. Not one document or even a scintilla of testimony was proffered indicating that Northern paid less than NGPA ceiling prices as if January 1, 1985, under authority of its ARCs. Clearly, Northern paid lower rates not because of, but in spite of its ARCs. (Tr. 832, 2243) If the ARCs empowered Northern to pay lower rates, there would have been no need to negotiate with Producers for contract amendments to decrease the price level.

Protestors had numerous opportunities to obtain evidence to show that the price reductions as of January 1, 1985, were pursuant to the ARCs in issue. Protestors were provided with voluminous documents regarding Northern's payments during this time period (Tr. 4341), and also reviewed all contracts and amendments at issue which were entered into from January 1, 1983, and thereafter. Additionally, Protestors had an opportunity to cross-examine Northern's witnesses and many Producer witnesses, as well as call these individuals as part of an affirmative case. Still, no evidence was introduced to support such a claim and the testimony of Northern and Producer witnesses shows that such speculation is unfounded. Despite Protestors' suggestions to the contrary, Northern was just one of the many interstate pipelines seeking rate reductions in gas purchase agreements on a unilateral basis.

In addition, it is obviously irrelevant that Northern attempted to renegotiate deregulation clauses covering

non-jurisdictional gas as of January 1, 1985. Northern sought to renegotiate these clauses because of an expected price "fly-up" when NGPA ceiling prices for such categories of gas were to be taken away effective January 1, 1985. Rates for these categories of gas, however, are not subject to ARCs. Renegotiation of contracts containing deregulation clauses was covered by Northern's "IPEC Plan" (P-R-14 at 6, 14; *See* Tr. 2423), which also included recognition of the problem of high-cost gas which would continue under regulation.

Protestors additionally allege that they have been denied discovery in regard to course of performance as of January 1, 1985, because of Northern's false and misleading actions. (PUCs Br. at 384-386) These allegations are unfounded. Any objections Protestors had regarding discovery or evidentiary matters should have been previously raised and if they believed the ruling incorrect, an appropriate appeal could have been pursued. In any event, Northern's payments as of January 1, 1985, have little relevance to the issue here; the Company's intent to pay all generally-applicable ceiling prices including those established by the NGPA, when entering into ARCs.

It is also significant that Northern lowered payments under all contracts containing ARCs beginning in 1985, regardless of language used in the clause. Some of those ARCs referred specifically to Congressional price-setting and the NGPA.

In sum, there is no evidence that Northern claimed its decreased payments for natural gas as of January 1, 1985, was in any way based on its obligations pursuant to ARCs. The evidence clearly shows that it attempted

to lower such payments despite its existing contractual duties and that there was no change in ARC meaning. Consequently, Northern's course of performance as of January 1, 1985 is not inconsistent with its asserted intent when entering into ARCs.

### VII. Usage of Trade

Under Section 1-205(2) of the U.C.C., a usage of trade is defined as "any practice or method of dealing having such regularity of observance in the place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question." *See also Pennzoil II* at 1143. It is not necessary to offer proof that each and every seller of gas observed the usage of trade, but only that the use was "observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree." U.C.C. § 1-205 (official comment 5). In each case it is a question of fact whether or not a usage of trade exists.

The Parties contend that a usage of trade was recognized among interstate pipelines and natural gas producers that ARCs would trigger payment of any ceiling rate established by federal regulation. To support this argument, they rely on the testimony of Mr. Jack Earnest, an expert on the purchasing practices of interstate pipelines and gas producers, and the collective testimony of the various Producer and Northern witnesses.

Mr. Jack Earnest held positions in the natural gas industry for a gas producer and various interstate pipelines ranging from Attorney to Chief Operating Officer, over approximately a forty year period. (IP-R-1 at 1-3) In addition, he has served as an arbitrator on matters

involving producers and pipelines on more than two dozen occasions (Tr. 2753) and has held leadership positions in the Natural Gas Supply Association and Interstate Natural Gas Association of America. (IP-R-1 at 2-3) Also, Mr. Earnest has been responsible for the drafting, negotiation, execution and administration of natural gas contracts. Because of his extensive experience with both natural gas producers and interstate pipelines, Mr. Earnest has the necessary background and knowledge to qualify as an expert as to the "regularity of observance" of ARC meaning among these entities. It is true, as Staff contends, that Mr. Earnest's expertise is only in the pipeline and producer segments of the gas industry. Staff contends, without explanation, that expertise is also required in the gathering and distribution segments to prove a usage of trade. Why this is so is not stated. Obviously, it is not so, for only the pipelines and producers negotiate contracts with ARCs. (Staff Br. at 69) Also, although the Northern and Producers witnesses were not presented as experts on the industry's use of ARCs, their combined individual testimony is given substantial consideration in deciding whether a usage of trade has been established, because they are the very people to whom Mr. Earnest ascribes a common understanding.

Based on his experience, Mr. Earnest testified that when ARCs were entered into, both buyers and sellers of natural gas recognized that the clause triggered payment of the highest price allowed by law applicable to the gas in question. (IP-R-1 at 16) He explained that to his knowledge all producers concurred with this view as did the majority of interstate pipelines. (*Id.*) Furthermore, he stated that ceiling prices were to be paid irrespective of the government authority establishing the

rates, how the rate was calculated, and regardless of the words used in the clause.

As Mr. Earnest noted, the understanding among gas industry members was so well known that ARC terms frequently were not specified during discussions and negotiations, but instead the terms "area rate clause" or "A/R" were used to signify that which everyone recognized. (IP-R-1 at 9) Consequently, what was negotiated among producers and pipelines was whether or not the ARC would be included in the contract at all; not the precise wording of such a provision. Regardless of how the clause was phrased, it always meant that the generally applicable ceiling rate was to be paid. Furthermore, although ARC wording changed over time in order to reflect the prevailing Commission regulations or industry understanding of those regulations, the difference in wording did not signal differences in intent. (See IP-R-1 at 12-13)

In addition to Mr. Earnest's testimony, the statements of the Northern witnesses and the fifty-seven Producer witnesses, who were cross-examined by the Protestors, show a "regularity of observance" as to ARC meaning. The Producer witnesses fairly reflected the views of gas producers generally, since they represented companies of various sizes and locations throughout the industry. As was explained *supra*, they unanimously stated that ARCs authorized them to collect the interstate ceiling price established by the federal government. (See e.g., PPC-R-1 at 5; MPC-R-1 at 3; MOC-R-4 at 4-5; PZL-R-1 at 3; AHC-R-1 at 4) Producer witnesses also testified, based on their own dealings, to the common meaning of ARCs in the gas industry. For example, Mr. George Kaiser of Kaiser-Francis Oil Company explained that

there were probably more than fifty other pipelines who purchased gas from his company under ARCs, and none objected to Kaiser-Francis' right to collect ceiling prices pursuant to the clause. (Tr. 5662-5663)

Northern's testimony also indicates that this trade usage existed. It was shown throughout this proceeding that Northern intended to pay the highest applicable ceiling price for gas subject to ARCs. Also, the Parties' position on ARC meaning parallels that taken by the Interstate Natural Gas Association of America (INGAA) in Docket Nos. RM79-3 and RM79-22. (See IP-R-2) Finally, in Order No. 23-B [*FERC Statutes and Regulations, Regulations Preambles* 1977-1981 ¶ 30,073], twenty-three interstate pipelines, which accounted for over 90% of the total volumes of natural gas purchased from independent producers in 1977, made evidentiary submissions acknowledging that they intended ARCs to allow payment of NGPA prices. (IP-R-1 at 21-24; See also IP-R-11) Each of these twenty-three companies, including Northern, have also manifested such an intent in formal pleadings with the FERC.

Although Protestors were unable to introduce one witness or even an iota of evidence that any person in the trade had a contrary view, they have advanced a series of arguments in rebuttal. First, they contend that a usage of trade does not exist in regard to NGPA rates because statutory rates were not triggered by ARCs prior to enactment of the NGPA, but that only NGA just and reasonable rates were permitted. (PUCs Br. at 455) This argument is simply a variation of an earlier assertion which was already disposed of, that the Parties only intended to pay just and reasonable rates because

many clauses only referred to such pricing. The Parties' true intent, as has been repeatedly explained, was to allow for payment of generally applicable ceiling prices. Despite the words used in some clauses, natural gas producers and interstate pipelines had a "regularity of observance" of paying and receiving the interstate ceiling price pursuant to ARCs, including NGPA rates. There was not the slightest suggestion in all of the testimony that only just and reasonable rates, however they are defined, were intended. Clearly, Protestors believe that a just and reasonable rate must be set in an administrative proceeding and must be cost-based. They never come to grips with the obvious fact that area, national and small producer rates, although administratively set, had incentive components, and that NGPA rates are, by Congressional definition, just and reasonable themselves.

Second, PUCs contend that such a trade usage could not have existed because it was unlawful to collect NGPA ceiling prices when ARCs were entered into. This argument is based on the PUCs' claim that ARCs only triggered payment of rates specifically referred to in Commission regulations. (PUCs Br. at 424) The evidence introduced here, however, shows that as to producers and pipelines, the clause had an expansive meaning covering all federally-established ceiling prices. Obviously, contracting parties did not specifically contemplate payment of NGPA prices before such rates existed, but they did intend for the highest applicable rate to be paid at all times.

Third, Protestors assert that since the Commission did not find a usage of trade in Order No. 23, no such

usage may be found in this proceeding. This argument is absurd and unfounded. A usage of trade is a factual determination made on a case-by-case basis. Order No. 23 was a rulemaking, where factual findings are not determinable. In this case, the requisite facts have been introduced to establish a trade usage. The failure of a trade usage to be found in Order No. 23 has no bearing here.

Fourth, PUCs attempt to impeach Mr. Earnest's testimony based on a prior proceeding where he offered his expert opinion on trade usage, *UGI Corp. v. Amoco Production Co.* No. 80-1421 (E.D. Pa. August 1, 1984) (unpublished). (PUCs Br. at 424-425) In that case, the Court found that a trade usage did not exist throughout the entire natural gas industry including LDCs such as UGI, because Mr. Earnest could only testify as to usage among interstate pipelines and producers, and LDCs often took positions opposing those of these entities. Here, however, we are concerned with the usage among pipelines and producers, and Mr. Earnest's expert testimony is certainly relevant and credible as to their understanding of ARCs.

Protestors also advance various other arguments in an attempt to attack Mr. Earnest's testimony, none of which are supported in any manner. They fault Mr. Earnest for not being familiar with the specific intent of individuals working for both pipelines and producers. He was, however, able to state that all individuals who worked for pipelines and producers with whom he was associated had a common interpretation of ARCs, and he believed that people in the industry generally shared this same view. Such testimony is precisely what is needed

to demonstrate a trade usage, rather than evidence of specific intent. Protestors also attack Mr. Earnest because he was not familiar with the documentation located in Producer and Northern's files. This argument is of no weight since the testimony he offered was used to show a "regularity of observance" from his personal knowledge. Consequently, investigating particular files was not necessary to establish the trade usage. Protestors asserted an assortment of other unproven arguments in an attempt to impeach Mr. Earnest. Mr. Earnest's experience and knowledge based on his dealings in the gas industry for over forty years, however, were certainly ample to qualify him as an expert, and all such arguments are found to be unsupported.

Fourth, Protestors claim that the testimony of more witnesses was necessary to prove usage of trade. (PUCs Br. at 448-449) The evidence offered by Mr. Earnest, fifty-seven producer witnesses, Northern witnesses, statements of the INGAA and of producers in Order No. 23, however, is certainly sufficient to substantiate an assertion of a general understanding as to ARC meaning. It was only necessary to prove that a "regularity of observance" regarding the intent of ARCs. It is not necessary to introduce the testimony of all pipelines and producers that exist to show a general understanding.

In sum, based on the overwhelming evidence introduced in this proceeding, it is found that a usage of trade existed among natural gas producers and interstate pipelines at the time ARCs were entered into, that the clause would trigger payment of the generally applicable ceiling price established for the gas in question. Although the burden of proof in this case is on the contracting parties, it is interesting to note that

Protestors could not find one witness out of all the producers and interstate pipelines to testify to a contrary meaning. Protestors arguments in rebuttal were disposed of above, and the ones not specifically addressed were considered and found to be without merit.

## VIII. Miscellaneous Issues

### *A. The Peoples' Evidence*

The Commission's order remanding this case for hearing was based on evidence that Peoples Natural Gas Company (Peoples), formerly a subsidiary, along with Northern, of InterNorth, Inc., had alleged that it was not obligated to pay NGPA ceiling prices pursuant to the ARCs in its intrastate gas purchase contracts. Peoples adopted this position in U.S. District Court declaratory judgment actions with McCoy Petroleum Company (McCoy) and Gear Petroleum Company (Gear). (P-R-48, 50, 51) Throughout this proceeding. Protestors have argued that Northern never intended to pay NGPA ceiling prices because its intent was the same as that which Peoples alleged in Federal Court. In order to determine whether Protestors have successfully refuted the Parties' claimed intent, the following two issues must be explored: 1) What actually was Peoples' intent when it entered gas purchase contracts containing ARCs?; and 2) Can Peoples' intent be imputed to Northern?

#### *1. Peoples' Intent*

In the order issued December 12, 1985, the Commission ruled that the Peoples evidence "can be attributed to Northern because of common control . . .", and therefore, sufficient evidence had been introduced to rebut the presumption in favor of the contracting parties'

stated intent. 33 FERC ¶ 61,355, at p. 61,706. The Commission, however, did not determine that the Peoples evidence reflected Northern's intent or that it even proved Peoples' intent, although Protestors seem not to recognize that.

At the hearing, Protestors, including Peoples, failed to present any additional evidence of Peoples' intent. Northern, however, sponsored the testimony of four witnesses who had worked for Peoples, Mr. Stanley Jervis, Mr. E. J. Holm, Mr. Merlin Remmenga and Mr. T. N. Wright, as well as that of Mr. John McCoy, Managing Partner of McCoy Petroleum Company. Mr. Wright has died between the time his testimony was filed and the hearing. That testimony, however, was originally presented at the "threshold" hearing in 1983 and Protestors declined the opportunity to cross-examine. The testimony is received in this case, but its weight is considered to be minor. In addition, Texaco, Inc. sponsored the testimony of Mr. Steven Baker, who negotiated gas purchase contracts with Peoples, when it was an InterNorth subsidiary.

Based on the record developed herein, there has been no showing that the position Peoples took in the *McCoy* and *Gear* cases was anything more than an unproven contention. The testimony submitted here, in fact, indicates that the more likely intent of Peoples was to pay interstate ceiling rates under ARCs.

Significantly, Mr. Holm, who was a gas buyer for Peoples from 1976 to 1978, has admitted that based on his intent in negotiating for Peoples, NGPA prices were to be paid under ARCs in its contracts. (NNG-R-21 at 12) Mr. Holm further explained that Producers

insisted that gas prices not fall below interstate rates, and that ARCs were used so that these rates could be maintained. (NNG-R-9 at 4) In addition, Mr. Jervis, who held various positions for Peoples, (including President from 1977-1980, also explained that ARCs were utilized to keep prices at the interstate rate or greater. (NNG-R-15 at 9) Mr. Jervis stated also that the intent under ARCs was the same regardless of the authority which established the interstate ceiling rate. (*Id.* at 9-10) The producer witnesses, Mr. McCoy and Mr. Baker, testified that they always believed the ARCs entitled them to the interstate ceiling price, if that rate exceeded the fixed prices in their contracts with Peoples. (NNG-R-18 at 2; TEX-R-6 at 9)

The evidence introduced at this proceeding shows that Peoples was temporizing when it formulated its position in the *McCoy* and *Gear* cases. The Company's concerns centered on the legal uncertainty regarding whether they would be allowed to pass through payments of NGPA prices by the Kansas Corporation Commission and the resulting economic effect if passthrough were denied. (NNG-R-15 at 4, 6-7; TEX-R-6 at 11) This legal uncertainty was caused by the unknown impact of enactment of both the NGPA and the Kansas Gas Price Protection Act. (NNG-R-15 at 6-7) When Mr. Wright advised in a memorandum that Peoples' interim position should be that NGPA rates should not be paid, he in fact noted this legal uncertainty. (P-R-11 at 1, 7; *See, e.g.* NNG-R-16 at 1. TEX-R-7) Mr. Baker also agreed that Peoples' position was based on economic factors. Therefore, regulatory concerns and potential economic consequences, rather than intent were the deciding factors in the Company's initial position regarding payment of

NGPA rates. Peoples was ultimately justified in having such reservations since the Kansas Commission denied passthrough on two occasions.

Peoples was also concerned with the interrelation of ARCs and Favored Nations Clauses that were in some agreements. These clauses provide for automatic increases in gas purchase prices if the rates under other gas purchase contracts are increased. If Peoples paid NGPA prices pursuant to ARCs, it believed it might be obligated to pay equal rates under Favored Nations Clauses. (See NNG-R-15 at 3; P-R-46; Tr. 1537-1538)

Protestors try to transform the issue of intent into an issue of truthfulness. They contend that since the allegations by Peoples in the *McCoy* and *Gear* cases were true, that Peoples intent has been proven. As with any alleged fact, however, the focus must be on whether the evidence substantiates the allegation, and not on bona fides of the pleader. Although Peoples may have in good faith alleged an intent contrary to that of Northern, it was never proven, and was certainly not established here. The inquiry in this case must be centered on the weighing of evidence, and not on honesty.

In sum, an ultimate finding of Peoples' intent cannot be made here, nor is such a finding necessary to the outcome of this proceeding. Based on the evidence submitted, however, it seems likely that Peoples did intend to pay NGPA rates under ARCs. Indeed, although Protestors claim that Peoples' payment of NGPA Section 104 prices was part of a settlement (PUCs Br. at 341), the record shows that Peoples regularly paid both Section 104 and 106 prices once these rates exceeded the fixed prices in its gas purchase contracts. (NNG-R-21 at 5;

TEX-R-6 at 10-12; Tr. 3784) Furthermore, Protestors once again disingenuously assert that the Parties did not prove their case because certain evidence was not introduced to refute the Peoples argument. If the Protestors sought to elicit particular testimony, however, they were under an obligation to present such witnesses in an affirmative case, or ask appropriate questions during cross-examination, rather than base their argument on mere conjecture. The Parties may conduct their case by whatever method they believe is most effective to meet their burden of proof. Protestors' arguments in this regard are misplaced in this proceeding.

## *2. The Effect of Peoples' Intent on Northern*

Although the Commission stated that Peoples' statements "can be attributed to Northern," there was no finding that People actually spoke for Northern. The Commission only found that the proffered evidence was sufficient to clear the initial, slightly burden some hurdle, and therefore "burst the presumption bubble" in favor of the Parties' intent.

It must be noted again that the successor to Peoples is a protestor in this proceeding, yet has not submitted testimony of any Peoples' witnesses or any documentation to support the Protestors' case. Certainly, if Northern and Peoples spoke as one, there should have been at least some evidence in the Company's file regarding such affiliation. Northern and Producers, to the contrary, did submit sufficient evidence to prove that the two entities functioned separately and in different regulatory environments. Consequently, even Protestors had shown that Peoples' never intended to pay NGPA rates, it would have no bearing on the outcome of this proceeding.

The evidence indicates that Northern and Peoples operated their companies independently. In particular, their gas acquisition functions were not at all interrelated. Each entity employed its own staff to negotiate gas purchase contracts and arrange supply matters. (NNG-R-8 at 3-4; NNG-R-4 at 4; NNC-R-7 at 3-4; NNG-R-13 at 4; NNG-R-14 at NNG-R-5; NNG-R-2 at 5; NNG-R-11 at NNG-R-10 at 3; NNG-R-12 at 2). Peoples' gas buyers included Mr. Jervis, Mr. Reneau, M. Holm and Mr. Mark Hays, none of whom were associated with Northern's buying activities. Peoples also had its own Manager of Gas Supply, Vice President of Supply and, as was mentioned earlier, Peoples had its own President Mr. Stanley Jervis. Mr. McCarthy explained his testimony that the two companies operate as if they were unaffiliated entities. (NNG-R-at 6-7) Furthermore, Mr. Dienstbier stated that Peoples' decisions only affected its own entity and in no way controlled Northern operations. (NNG-R-14 at 4) Mr. Wright's testimony was consistent with this view. He additionally noted that the two entities had entirely separate locations, Peoples operating in Iowa and Northern in Nebraska. (NNC-R-20 at 1-2)

The Producers who contracted with Peoples also understood that the two gas pipeline entities were not the same. Mr. McCoy testified that when selling gas to Peoples, his company only had contact with Peoples' personnel. (Tr. 1767-1768) Also, Peoples previously informed Mr. Baker of Texaco, that it was a separate entity from Northern, and that each company negotiated independently of the other. (TEX-R-13 at 1)

Additionally, it was shown that Peoples and Northern conducted business in different regulatory environments,

and therefore formulated their policies on payment of NGPA rates based on entirely different considerations. Peoples, an LDC, was under state regulation, while Northern, an interstate pipeline, was and is regulated by the FPC/FERC. As was shown *supra*, Peoples was primarily concerned with whether the Kansas Commission would allow payment of NGPA prices to be passed through to its customers. Northern, however, focused on its intent when deciding to pay NGPA ceiling prices. Also, the companies' independence is evident from their decision making processes. Peoples, *after* enactment of the NGPA, decided among its own personnel that it should not initially pay NGPA prices. Northern, however, *prior* to enactment of the NGPA, determined that it should pay such rates, and has consistently maintained that this obligation exists under its ARCs. Not once did the two entities consider the actions or views of the other, nor did they even look to similar criteria when analyzing the issue.

Protestors claim that the two entities actually functioned as one. They first try to support this theory by pointing to evidence that all of InterNorth's subsidiaries were organized into the Natural Gas Group, of which both Peoples and Northern were members. (PUCs Br. at 347-349) Mr. Severa was the President of the Natural Gas Group and responsible for the natural gas functions of InterNorth. (Tr. 2370) Protestors claim, based upon their view of corporations in general, that since Mr. Severa made decisions affecting both companies, they were affiliated such that they functioned as one entity. The evidence shows, though, that the companies' gas supply decisions were made separately. Furthermore, Mr. Severa agreed with Northern's decision

to pay NGPA rates (Tr. 2371-2372, 2283-2286), and allowed Peoples to make a decision on its own contracts. The Natural Gas Group never met to vote on decisions to be made by the subsidiary companies, but rather was established primarily to serve as a forum for the companies to exchange views. (Tr. 2369, 2383-2384)

Second, Staff asserts that because Northern and Peoples generally pursued the same objectives, there was a cross-over of decision making between the companies. (Staff Br. at 85-90) Merely because both entities were faced with resolving the same issues, however, does not prove that they functioned as one company. It was obviously not uncommon for most intrastate and interstate pipelines to be concerned with the impact of enactment of the NGPA on their companies.

Third, PUCs stress that Northern's Law Department represented both Peoples and Northern. (PUCs Br. at 350) Although the Law Department did offer their services to both companies in certain operations areas, the record unarguably shows that as to ARC intent the decision making processes were separate. Mr. McCarthy and Mr. Wright advised Northern and Peoples, respectively, and each offered different conclusions, based on a separate set of facts and criteria. Mr. McCarthy advised that NGPA rates should be paid, while Mr. Wright recommended that Peoples should not initially pay such prices. Furthermore, Protestors mention that Mr. Madigan, an attorney in Northern's Law Department, advised both companies on contract issues. The record does indicate that Mr. Madigan worked with each entity at various times. An overlap of decision making is not substantiated, however, merely by showing that one attorney advised two clients.

Finally, PUCs argue that whether or not the companies are affiliated is irrelevant, since ARCs were intended to have a uniform meaning. (PUCs Br. at 339) This is an absurd contention and fails to consider the separate environments in which intrastate and interstate pipelines function. Although, as it was found *supra*, ARCs had a uniform meaning among interstate pipelines and producers, no such assertion was made or proven in regard to intrastate pipelines. The evidence overwhelmingly shows that Northern intended to pay NGP Aceiling prices under ARCs. As to intrastate pipelines, however, no such showing was made, nor would it have been relevant here. We are concerned here with Northern's intent only, and that was conclusively proven in this proceeding.

In sum, Northern and Peoples operated as separate companies. The two entities had independent structures and had an overlap of management as would be expected for any common subsidiaries. There was no indication of a commonality of actions or policy between Northern and Peoples.

Even if it had not been proven, there is absolutely no evidence to demonstrate that in a conflict of views, those of the Peoples division would prevail over those those of its much larger corporate brother.

#### B. NGPA Section 104 and 106 Rates

On September 22, 1982, the Commission issued an order pursuant to a certified question in this case, explaining that NGPA Section 104 and 106(a) rates were in issue here. 20 FERC ¶ 61,329. In light of the findings made herein, that the Parties intended all applicable

NGPA rates to be paid pursuant to ARCs, Section 104 and 106(a) prices were triggered in the contracts at issue between Northern and Producers, and no separate consideration of those rates is necessary.

### *Conclusion*

Northern Natural Gas Company and its Producers, as representatives of all its producers, have conclusively shown that, at the time they entered into contract containing area rate clauses, they intended the clause to trigger payment of all generally-applicable ceiling prices established by federal authority. Protestors arguments to the contrary are who unsupported by the record and have been convincingly refuted by the contracting parties.

### *Order*

Wherefore, it is ordered, subject to the Commission's Rules of Practice and Procedure, that the protests in this proceeding are dismissed and that the proceeding is terminated.

